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INCOME-TAX CASES.

Nos. 140, 213, 359, 393, 394, 396.

In the Supreme Court of the United States.

OCTOBER TERM, 1915.

FRANK R. BRUSHABER, APPELLANT,

v.

UNION PACIFIC RAILROAD COMPANY.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

Also four other cases advanced for hearing with the preceding cases, viz:

JOHN F. DODGE AND HORACE E. DODGE, APPELLANTS, *v.* JAMES J. BRADY, COLLECTOR OF INTERNAL REVENUE;

JOHN R. STANTON, APPELLANT, *v.* BALTIC MINING COMPANY ET AL.;

TYEE REALTY CO., PLAINTIFF IN ERROR, *v.* CHAS. W. ANDERSON, COLLECTOR OF INTERNAL REVENUE;

EDWIN THORNE, PLAINTIFF IN ERROR, *v.* CHARLES W. ANDERSON, COLLECTOR OF INTERNAL REVENUE;

and

JOHN F. DODGE AND HORACE E. DODGE, APPELLANTS, *v.* WILLIAM H. OSBORN, COMMISSIONER OF INTERNAL REVENUE, ON MOTION TO DISMISS OR AFFIRM.

BRIEF FOR THE UNITED STATES.

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In the Supreme Court of the United States.

OCTOBER TERM, 1915.

FRANK R. BRUSHABER, APPELLANT,
v.
UNION PACIFIC RAILROAD COMPANY. } No. 140.

APPEAL FROM THE DISTRICT COURT OF THE UNITED STATES FOR THE SOUTHERN DISTRICT OF NEW YORK.

Also four other cases advanced for hearing with the preceding case, viz:

John F. Dodge and Horace E. Dodge, appellants, *v.* James J. Brady, collector of internal revenue; } No. 213.

John R. Stanton, appellant, *v.* Baltic Mining Company et al.; } No. 359.

Tyee Realty Co., plaintiff in error, *v.* Charles W. Anderson, collector of internal revenue; } No. 393.

Edwin Thorne, plaintiff in error, *v.* Charles W. Anderson, collector of internal revenue; } No. 394.

and

John F. Dodge and Horace E. Dodge, appellants, *v.* William H. Osborn, commissioner of internal revenue, on motion to dismiss or affirm. | No. 396.

BRIEF FOR THE UNITED STATES.

STATEMENT.

This brief is filed by leave of court in all of the above named cases. In two (No. 140, Brushaber, and No. 359, Stanton) the appearance is as *amicus curiæ*. In four (No. 140, Brushaber; No. 359, Stanton; and Nos. 313 and 396, the two Dodge cases) the jurisdiction of the court below is challenged. Independently of this jurisdictional feature, they all invite various questions affecting the constitutionality of section II of the act of Congress approved October 3, 1913 (38 Stat. 166, 181), known as the Income-Tax Act of 1913. This section is printed in full as an appendix to this brief.

Cases No. 395 (Tyee Realty Co.), No. 140 (Brushaber), and No. 359 (Stanton), involve corporation taxes; the others involve taxes of individuals. No. 395 involves a realty, No. 140 a railroad, and No. 359 a mining corporation. All three were organized for profit.

This brief will discuss under appropriate general headings every question deemed worthy of consideration that has been argued in any of the briefs

for appellants or plaintiffs in error, as if all the questions were presented in a single case. It will indicate as to each point discussed, the cases in which it is urged.

ARGUMENT.

JURISDICTION.

In No. 140 (Brushaber) and No. 359 (Stanton) a stockholder seeks to restrain the corporation taxpayer from voluntarily paying its tax. In Nos. 213 and 396 (the two Dodge cases) individual taxpayers seek to restrain the collection of their taxes; and the supplemental bill in No. 213, though filed after payment of the tax, was yet filed *before* any decision of the Commissioner on their appeal.

Division L of the Income-Tax Act of October 3, 1913, (38 Stat. 179) provides:

> * * * the laws in relation to the assessment, remission, collection, and refund of internal revenue taxes, not heretofore specifically repealed, and not inconsistent with the provisions of this section, are hereby extended and made applicable to all the provisions of this section and to the tax herein imposed.

Section 3224, R. S., provides:

> No suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court.

Section 3226, R. S., provides:

> No suit shall be maintained in any court for the recovery of any internal * * * tax alleged to have been * * * *illegally* assessed or collected * * * until appeal shall have been duly made to the Commissioner of Internal Revenue * * * and a decision of the Commissioner has been had therein; * * * .

To avoid these statutes, in terms plainly forbidding these four suits, appellants claim (1) that if so read they would violate section 2, Article III, of the Constitution, reading:

> The judicial power shall extend to all cases in law and equity arising under * * * the laws of the United States; and * * * to controversies to which the United States shall be a party; * * *

and (2) that they do not apply where there is utter lack of jurisdiction to assess.

1. Sections 3224, R. S., and 3226, R. S., are constitutional.

Though in effect since 1867 and 1866, respectively, and often applied by courts, these sections are now for the first time assailed as unconstitutional. They but follow and complete the tax collecting procedure of the common law. Injunction was not used in England nor in the colonies to correct illegal taxation. Moreover, "judicial power" does not necessarily embrace tax controversies.

In *Murray's Lessee* v. *Hoboken L. & I. Co.*, 18 How. 272, 282, this court said:

> * * * it may be added, that probably there are few governments which do or can permit their claims for public taxes, either on the citizen or the officer employed for their collection or disbursement, to become subjects of judicial controversy, according to the course of the law of the land. Imperative necessity has forced a distinction between such claims and all others, which has sometimes been carried out by summary methods of proceeding, and sometimes by systems of fines and penalties, but always in some way observed and yielded to.

In *Nichols* v. *United States*, 7 Wall. 122, the court said:

> It would be impossible for it (the Government) to collect revenue for its support, without infinite embarrassment and delays, if it was subject to civil processes the same as a private person. (126.) * * * The allowing a suit at all, was an act of beneficence on the part of the Government. As it had confided to the Secretary of the Treasury the power of deciding in the first instance on the amount of duties demandable on any specific importation, so it could have made him the final arbiter in all disputes concerning the same. (127.)

See also *United States* v. *Pacific R. R.*, 4 Dillon 66.

2. These procedural statutes apply to any tax, however illegal and however the illegality may arise.

Though the assessment be under a law that may be ultimately held invalid, a tax levied by officers according to its mandate would be one levied under color of office and its collection could not be restrained.

In *Snyder* v. *Marks,* 109 U. S. 189, this court said:

> Hence, when, on the addition to the section, a "tax" was spoken of, it meant that which is in a condition to be collected as a tax and is claimed by the proper public officers to be a tax, although on the other side it is alleged to have been erroneously or illegally assessed. It has no other meaning in section 3224. There is therefore, no force in the suggestion that section 3224, in speaking of a "tax," means only a legal tax; and that an illegal tax is not a "tax" and so does not fall within the inhibition of the statute and the collection of it may be restrained. (192.) * * * The inhibition of 3224 applies to all assessments of taxes *made under color* of *their offices* by internal revenue officers charged with general jurisdiction of the subject of assessing taxes against tobacco manufacturers. The remedy of a suit to recover back the tax after it is paid is provided by statute, and a suit to restrain its collection is forbidden. The remedy so given is exclusive and no other remedy can be substituted for it. Such has been the current of

> decisions in the circuit courts of the United States, and we are satisfied it is a correct view of the law. (Citing cases.) In *Cheatham* v. *United States,* 92 U. S. 85, 88, and again in *State Railroad Tax Cases,* 92 U. S. 575, 613, it was said by this court that the system prescribed by the United States in regard to both customs duties and internal revenue taxes, of stringent measures, not judicial, to collect them, with appeals to specified tribunals, and suits to recover back moneys illegally exacted, was a system of corrective justice intended to be complete and enacted under the right belonging to the Government to prescribe the conditions on which it would subject itself to the judgment of the courts in the collection of its revenues. In the exercise of that right it declares by section 3224 that its officers shall not be enjoined from collecting the tax claimed to have been unjustly assessed when those officers, in the course of general jurisdiction over the subject matter in question, have made the assignment (assessment) and claim that it is valid. (193–194.)

Some earlier circuit court cases, opposed to the *Snyder* case, *supra,* are commented on in *Kinsett* v. *Stephens,* 18 Blatchf. 397, by Judge Blatchford, who later delivered the opinion in the *Snyder* case.

It is now settled that a tax can not be enjoined because of its unconstitutionality. *Shelton* v. *Platt,* 139 U. S. 591; *Allen* v. *Pullman's Palace Car*

Co., 139 U. S. 658. The only class of cases falling outside of the statute (3224 R. S.) are those wherein there is no color of authority for the assessment, and even then additional equities must intervene. In these present cases the taxes have been assessed confessedly under color of law, for the main argument is that the law *requiring the assessment* is unconstitutional.

Notwithstanding a general assertion of the sort, no facts are alleged indicating any greater danger of multiplicity of suits, or clouds on titles, in connection with the enforcement of these taxes, than in the case of any other tax. *Dows* v. *Chicago*, 11 Wall. 108; *Southern Railway Co.* v. *King*, 217 U. S. 524, 534, 536. That thousands of different taxpayers would be forced to sue, each for his own tax, does not constitute "multiplicity." One individual or a set of individuals must be compelled to institute many suits to establish a single or common right before "multiplicity" can arise.

These principles govern not only the Dodge cases, but the Brushaber and Stanton cases as well. "The purpose" of these two latter suits is to restrain the collection of the income tax, else they necessarily present but moot questions not reviewable by courts. To be effective the relief must protect the corporation against any liability to pay the tax. Either the injunction would be a good defense to the corporation against attempts of the collector to enforce the tax, or it would be a mere *brutum fulmen*.

On account of the peculiar circumstances there obtaining, the assumption of jurisdiction in the *Pollock* case (157 U. S. 429) can not be taken as authority. In *Straus* v. *Abrast Realty Co.*, 200 Fed. 327, Judge Veeder held that these statutes prevent a suit by a stockholder against a corporation to restrain the latter from paying a Federal tax; and speaking of the *Pollock* case in *Corbus* v. *Gold Mining Co.*, 187 U. S. 455, 459, this court said:

> But that case does not determine to what extent a court of equity will permit a stockholder to maintain a suit nominally against the corporation but really for its benefit.

And on pages 461–463 this court applied the principle laid down in *Hawes* v. *Oakland*, 104 U. S. 450, to a bill to restrain a corporation from paying a tax, thereby confining the jurisdiction to cases where the directors are clearly acting *ultra vires*, or where they, or a majority of the stockholders, are threatening action in their own interest to the detriment of the corporation, all of which must appear by averment of specific facts rather than by general allegation. *Southern Railway Co.* v. *King, supra.* These bills do not negative the possibility that the directors are acting in good faith for what they believe to be the best interest of the corporation, and the mere threatened payment of a tax which some stockholder claims to be unconstitutional is not an *ultra vires* act.

The supplemental bill in No. 213 (Dodge-Brady case) even with the aid of Equity Rule 22 can not give the court belated jurisdiction, (a) because the cause was never transferred to the law side of the court as required by the rule, and without transfer no jury trial could have been had on any issue that might afterwards have been joined upon any of the matter averred in paragraphs VIII and XI and the first sentence of XII of the bill; (b) the prayer for equitable relief was still continued; and (c) at the time of the filing of the supplemental bill there had been no decision by the Commissioner on the appeal taken by Dodge Brothers.

Assignment No. 1 (p. 5, additional brief, Dodge-Brady case, No. 213), complaining of a dismissal without reservation, may not be considered, because (1) it goes not to the legal propriety, but only to the *form* of dismissal, and no such error was assigned in connection with the appeal when taken (R., 43); and (2) appellants did not, in the court below, either object to the form or apply to that court to change the form of the decree.

The Government is insistent upon its contention of lack of jurisdiction as to the cases affected thereby, because it deems it important that complaining taxpayers be, in the future, confined to proper procedure, to the end that the confusion and embarrassment otherwise resulting to the revenue may hereafter be avoided.

THE MERITS.

I.

LACK OF UNIFORMITY CAN NOT BE SUCCESSFULLY URGED.

1. Income taxes. at least when laid on income derived from real or personal property, are direct taxes, and therefore not subject to the uniformity rule, EXPRESSLY prescribed by the Constitution.

(*a*) It is settled that the uniformity requirement of clause 1 of section 8 of Article I of the Constitution, is limited to duties, imposts, and excises, and does not apply to *direct* taxes. *Pollock* v. *F. L. & T. Co.*, 157 U. S., 557; *Spreckels Sugar Refining Co.*, v. *McLean*, 192 U. S. 397, 413; *License Tax Cases*, 5 Wall. 462, 471. And the *Pollock* case (158 U. S. 601, 637), finally determines that a tax on income derived from either real or personal property is a *direct* tax. In none of the cases at bar does the record affirmatively show that there is involved any tax on income derived from any other source; for in the *Dodge* cases, the return was on invested capital, whether the partnership income be regarded as from the plant (realty)or from the manufacture and sale of automobiles (personalty). Therefore, no question as to any other kind of income tax is now before this court. *Flint* v. *Stone Tracy Co.*, 220 U. S. 107, 177; *Southern Ry.* v. *King*, 217 U. S. 534; and *Hatch* v. *Reardon*, 204 U. S. 160 and cases.

(*b*) Apportionment being restricted to *direct* taxes *only* (*Flint* v. *Stone Tracy Co.*, *supra* 152), the Sixteenth Amendment, in removing that restric-

tion, recognized *any* tax upon income " from whatever source derived " as a *direct* tax, and as such subject to the apportionment rule unless specially exempted.

In appellant's brief in the Dodge-Osborn case (No. 396), it is said:

> That decision (Pollock case) was authoritative and final. The Sixteenth Amendment recognizes it as a permanent interpretation of the Constitution. (9.)

(*c*) In their briefs in all these cases appellants admit that the taxes here involved are *direct*. Brushaber brief, pages 14, 16, 66–69; Dodge-Brady brief (Baker), pages 20, 22; (Guthrie), pages 6, 10–12 (quoting and distinguishing the *Flint* case); Dodge-Osborn brief, page 9; Stanton brief, pages 3, 4, 36, 59, 74, 96, 114, 130, 136, 140; Thorne brief, pages 19, 38, 45, 47.

2. The Constitution imposes on the taxing power no rule of IMPLIED or inherent uniformity.

If uniformity was an essential of every *tax*, then the provision that " all duties, etc., shall be uniform throughout the United States " might as well have been omitted from the Constitution. This court, however, has repeatedly said that this express limitation, as well as that of *apportionment*, found in clause 4 of section 9 of Art. III and clause 3 of section 2 of Art. I, is vital. In the *Pollock* case, *supra* (157 U. S. 557), this court quotes from the opinion of Mr. Chief Justice Chase

in the *License Tax Cases,* 5 Wall. 462, 471, as follows:

> It is true that the power of Congress to tax is a very extensive power. It is given in the Constitution, with only one exception and *only two qualifications.* Congress can not tax exports, and *it must impose direct taxes by the rule of apportionment, and indirect taxes by the rule of uniformity. Thus limited, and thus only, it reaches every subject, and may be exercised at discretion.*

What language could more clearly express the idea that the power is unlimited save by these two qualifications? Referring to excises in *Patton* v. *Brady,* 184 U. S. 608, this court said:

> The exercise of the power is therefore limited by the rule of uniformity. The framers of the Constitution, the people who adopted it, *thought that limitation sufficient, and courts may not add thereto.* (622.)

See also *McCray* v. *United States,* 195 U. S. 27; *Flint* v. *Stone Tracy Company, supra.*

If they may not add to the express limitation of uniformity in clause 1, *supra,* how may they add to the express limitation of apportionment in clause 4, *supra,* an additional *implied* requirement of uniformity; and why was the requirement of uniformity expressly inserted in the former clause, and entirely omitted from the latter?

Appellants in the Thorne brief (p. 39) quote Mr. Cooley as follows:

> And as all are alike protected, so all alike should bear the burden.

In the text the sentence reads:

> And as all are alike protected, so all alike should bear the burden, *in proportion to the interest involved.*

The underscored words dispense with absolute equality, and preserve the right of selection of subjects and classes of persons to be taxed. As uttered by the author, the rule is correctly stated; as excised by appellant, it is not.

Equality of taxation as between individuals can not be developed from either the "equal protection" or the "due process" clauses of the Fourteenth Amendment, because that amendment has no application to the Federal Government; nor from the Fifth Amendment, because that amendment in nowise limits the taxing power of Congress. *Billings* v. *United States,* 232 U. S. 261, 282. Moreover, neither of these amendments would demand any such result if they could be applied. This will be elaborated later.

3. The rule of uniformity, where applicable, is not violated by either exemption, classification, or discrimination unless these be so arbitrary and outrageous as to indicate favoritism or prejudice.

Assume for the sake of argument a tax controlled by the uniformity rule. The taxing power and the

war power are the broadest powers of government. Surely, if the former carries the right to destroy, any mere hardship or illogical or unscientific application can not defeat a taxing statute.

In *Knowlton* v. *Moore,* 178 U. S. 41, this court, speaking through the present Chief Justice, said:

> * * * if a lawful tax can be defeated because the power which is manifested by its imposition may when further exercised be destructive, it would follow that every lawful tax would become unlawful, and, therefore, no taxation whatever could be levied. (60.)

In *Flint* v. *Stone-Tracy Co.,* 220 U. S. 107, this court, through Mr. Justice Day, said:

> The argument, at last, comes to this: That because of possible results, a power lawfully exercised may work disastrously, therefore the courts must interfere to prevent its exercise, because of the consequences feared. No such authority has ever been vested in any court. (169.)

The rule against discrimination applicable to antitrust cases, rate-regulation cases, etc., is not the correct measure of the limitation in this regard on the taxing power.

In *Cook* v. *Marshall County,* 196 U. S. 261, this court, speaking of antitrust and rate regulation cases, said:

> These cases, however, have but limited application to laws imposing taxes where the right of classification is held to permit of

> discrimination between different trades and callings *when not obviously exercised in a spirit of prejudice or favoritism.* (Citing cases.) (274.)

Again, speaking of the subject from the standpoint of the taxing power, and in *Nicol* v. *Ames*, 173 U. S. 509, this court said:

> The question always is when a classification is made, whether there is any reasonable ground for it, or whether it is *only* and simply arbitrary, based upon no real distinction and entirely unnatural. (Citing cases.) If the classification be proper and legal, then there is the requisite uniformity in that respect. (521.)

Mindful of these considerations, let us now see how this court has applied each, the *express* limitation of uniformity in clause 1 of section 8 of the Constitution, and the alleged *implied* requirement of uniformity sought to be deduced from the Fifth Amendment; or even through the Fifth, from the Fourteenth Amendment.

A. The express uniformity clause of the Constitution requires only geographical and not intrinsic uniformity.

It is no longer open to debate that the words, "shall be uniform throughout the United States," in clause 1, section 8, Article I of the Constitution require *geographical* uniformity only; and that the latter term means not intrinsic equality operating alike on all persons subject to a tax, but only like

operation on those within the *same class* in *every part* of the United States.

In *Knowlton* v. *Moore, supra,* this court, construing the Legacy Tax of 1893 ,and speaking through the present Chief Justice, states the opposing contentions and the conclusions of the court as follows:

> On the one side the proposition is that the command that duties, imposts, and excises shall be uniform throughout the United States relates to the inherent and intrinsic character of the tax; that it contemplates the operation of the tax upon the property of the individual taxpayer and exacts that when an impost, duty, or excise is levied it shall operate precisely in the same manner upon all individuals; that is to say, * * * shall be equal and uniform in their operation upon persons and property in the sense of the meaning of the words "equal and uniform," as now found in the constitutions of most of the States of the Union. The contrary construction is this: That the words "uniform throughout the United States" do not relate to the inherent character of the tax as respects its operation on individuals, but simply requires that whatever plan or method Congress adopts for laying the tax in question, the same plan and the same method must be made operative throughout the United States; that is to say, that wherever a subject is taxed anywhere the same must be taxed everywhere throughout the United States, and at the same rate. (84.)
> * * *

> By the result, then, of an analysis of the history of the adoption of the Constitution it becomes plain that the words "uniform throughout the United States" do not signify an intrinsic, but simply a geographical uniformity. (106.)

In *Billings* v. *United States,* 232 U. S. 261, this court, through the present Chief Justice, said:

> It has been *conclusively* determined that the requirement of uniformity which the Constitution imposes upon Congress in the levy of excise taxes is not an intrinsic uniformity, but merely a geographical one. (Citing the *Flint, McCrea,* and *Knowlton* cases.) (282.)

B. Assuming also that the Fifth Amendment controls the taxing power—as it does not—and even that the "equal protection" requirement of the Fourteenth Amendment may be either read into or spelled out of the language of the Fifth Amendment—as it may not—neither would operate to forbid reasonable exemption, classification, or discrimination.

This court has twice, for argument's sake merely, assumed that which appellants apparently take as the basis of the major part of their argument, i. e., that the "equal protection" clause is to be treated as a part of the Fifth Amendment. Thus considering the subject, it has decided (1) that the limitation imposed on Congress by the Fifth Amendment at most can not be greater than that imposed on the States by the Fourteenth Amendment, and therefore if the Fourteenth Amendment does not operate to deprive the States of the power to exempt or classify, no more can the Fifth Amendment so operate as against the General Government.

In *District of Columbia* v. *Brooke*, 214 U. S. 138, this court, through Mr. Justice McKenna, said:

> However, the question of the power of Congress, broadly considered, to discriminate in its legislation is not necessary to decide, for whether such power is expressly or impliedly prohibited, the prohibition can not be stricter or more extensive than the Fourteenth Amendment is upon the States. That Amendment is unqualified in its declaration that a State shall not "deny to any person within its jurisdiction the equal protection of the laws." Passing on that Amendment, we have repeatedly decided—so often that a citation of the cases is unnecessary—that it does not take from the States the power of classification. And also that such classification need not be either logically appropriate or scientifically accurate. The problems which are met in the government of human beings are different from those involved in the examination of the objects of the physical world and assigning them to their proper associates. A wide range of discretion, therefore, is necessary in legislation to make it practical, and we have often said that the courts can not be made a refuge from ill-advised, unjust, or oppressive laws. (150.)

And again in the *Second Employers' Liability cases*, 223 U. S. 1, this court, through Mr. Justice Van Devanter, said:

> But it does not follow that this classification is violative of the "due process of law"

> clause of the Fifth Amendment. Even if it be assumed that that clause is equivalent to the " equal protection of the laws " clause of the Fourteenth Amendment, *which is the most that can be claimed for it here,* it does not take from Congress the power to classify, nor does it condemn exertions of that power merely because they occasion some inequalities. On the contrary, it admits of the exercise of a wide discretion in classifying according to general, rather than minute, distinctions, and condemns what is done only when it is without any reasonable basis, and therefore is purely arbitrary. (52, 53.)

That the Fourteenth Amendment does not prevent exemptions or classifications not arbitrary in their nature is no longer an open question. *Barrett* v. *State of Indiana,* 229 U. S. 26, 29; *International Harvester Co.* v. *Missouri,* 234 U. S. 199, 214, 215; *Metropolis Theater Co.* v. *Chicago,* 228 U. S. 61, 69; *Lindsley* v. *National Carbonic Gas Co.,* 220 U. S. 61, 78.

Appellants rely on *Southern Railway Co.* v. *Greene,* 216 U. S. 400, in which case this court refused to sanction a certain legislative classification. Later, in the *Billings* case, *supra,* when, as appears from the reported synopsis of briefs there were pressed upon this court the *Lindsley* and *Barrett* cases, *supra,* on the one hand, and the *Southern Railway Co.* case upon the other—though the latter, like the *Billings* case, involved discrimination in rate as between a domestic and a foreign taxpayer—it up-

held the principle of *Lindsley* and *Barrett* cases, which we claim are controlling here. The State enactment involved in the *Southern Railway Co.* case was held to violate the Fourteenth Amendment; but the Federal power involved in the *Billings* case was held to be unaffected by either the Fourteenth or Fifth Amendments.

As to the power to exempt, this court in *Gibbons* v. *District of Columbia,* 116 U. S. 404, said:

> In the exercise of this power, Congress, like any State legislature unrestricted by constitutional provisions, may at its discretion wholly exempt certain classes of property from taxation or may tax them at a lower rate than other property. (408.)

In *Beers* v. *Glynn,* 211 U. S. 477, this court quoted from its opinion in *Magoun* v. *Illinois Trust & Savings Bank,* 170 U. S. 299, as follows:

> Nor do the exemptions of the statute render its operation unequal within the meaning of the Fourteenth Amendment. The right to make exemptions is involved in the right to select the subject of taxation and apportion the public burdens among them, and must consequently be understood to exist in the lawmaking power wherever it has not in terms been taken away. To some extent it must exist always, for the selection of subjects of taxation is of itself an exemption of what is not selected. Cooley on Taxation, 200; see also the remarks of Mr. Justice Bradley in *Bell's Gap Railroad* v. *Pennsylvania,* 134 U. S. 232. (482.)

See also *Welch* v. *Cook*, 97 U. S. 541; *Home of the Friendless* v. *Rouse*, 8 Wall. 430; *Salt Co.* v. *East Saginaw*, 13 Wall. 373.

Finally, noticing a single additional contention advanced in one of appellants' briefs, in connection with alleged limitations on the Federal power of taxation, we deem it sufficient to say that we feel that nothing would be gained by discussing the distinction attempted to be drawn by counsel in the *Brushaber* brief (pp. 23–25) between so-called "primary powers" of Congress and its "secondary or ancillary powers."

C. Selection and classification is an exclusive function of Congress until its exercise becomes plainly the result of prejudice or favoritism.

The largest latitude is allowed. Nothing short of action so arbitrary as to clearly indicate favoritism or prejudice will justify interference with a taxing statute. Cooley on Constitutional Limitations, third edition, page 739, says:

> The constitutional requirement of equality and uniformity only extends to such objects of taxation as the legislature shall determine to be properly subject to the burden. *The power to determine the persons and the objects to be taxed is trusted exclusively to the legislative department* * * *.

In *Pacific Insurance Co.* v. *Soule*, 7 Wall. 433, this court said:

> Congress may prescribe the basis, fix the rates, and require payment as it may deem

proper. Within the limits of the Constitution it is supreme in its action. No power of supervision or control is lodged in either of the other departments of the Government. (443.)

In *McCray* v. *United States,* 195 U. S. 27, this court, speaking through the present Chief Justice, quoted from *Veazie Bank* v. *Fenno,* 8 Wall. 548, as follows:

> The power to tax may be exercised oppressively upon persons but the responsibility of the legislature is not to the courts but to the people by whom its members are elected. (57.) * * * The right of Congress to tax within its delegated power being unrestrained except as limited by the Constitution, it was within the authority conferred on Congress to select the objects upon which an excise should be laid. (61.)

In *Treat* v. *White,* 181 U. S. 264, this court said:

> The power of Congress in this discretion is unlimited. (269.)

In the *Flint* case, *supra,* this court quoted from *Patton* v. *Brady, supra,* as follows:

> It is no part of the function of a court to inquire into the reasonableness of the excise, either as respects the amount or the property upon which it is imposed. (167.)

In *Lindsley* v. *Natural Carbonic Gas Co.,* 220 U. S. 61, this court, speaking through Mr. Justice Van Devanter, said:

> A classification having some reasonable basis does not offend * * * merely be-

> cause it is not made with mathematical nicety or because in practice it results in some inequality. (78.)

In *Metropolis Theater Co.* v. *Chicago,* 228 U. S. 61, this court, through Mr. Justice McKenna, said:

> To be able to find fault with a law is not to demonstrate its invalidity. It may seem unjust and oppressive, yet be free from judicial interference. The problems of government are practical ones and may justify, if they do not require, rough accommodations—illogical, it may be, and unscientific. * * * It is only its *palpably arbitrary* exercise which can be declared void under the Fourteenth Amendment; (69.) * * *

In *International Harvester Co.* v. *Missouri,* 234 U. S. 199, this court also, through Mr. Justice McKenna, said:

> * * * it is competent for a legislature to determine upon what differences a distinction may be made for the purpose of statutory classification between objects otherwise having resemblances. Such power, of course, can not be arbitrarily exercised; the distinction must have reasonable basis. (215.)

In *Barrett* v. *State of Indiana,* 229 U. S. 26, this court, through Mr. Justice Day, said:

> The equal protection of the laws requires laws of like application to all similarly situated, but in selecting some classes and leaving out others the legislature, while it keeps

within this principle, is, and may be, allowed wide discretion. * * * The legislature is permitted to make a reasonable classification, and before a court can interfere with the exercise of its judgment it must be able to say that there is no fair reason for the law that would not require with equal force its extension to others whom it leaves untouched. (29, 30.)

In *Nicol* v. *Ames, supra,* this court said:

> The question always is, when a classification is made, whether there is any reasonable ground for it, or whether it is *only* and simply *arbitrary, based upon no real distinction* and *entirely unnatural.* (521.)

4. None of the exemptions or discriminations here complained of produce lack of uniformity.

Before considering each alleged illegal exemption or discrimination, let us recall the burden appellants assume in asking this court to declare this tax act unconstitutional.

In *Nicol* v. *Ames, supra,* this court said:

> It is always an exceedingly grave and delicate duty to decide upon the constitutionality of an act of the Congress of the United States. The presumption, as has frequently been said, is in favor of the validity of the act, and it is only when the question is free from any reasonable doubt that the court should hold an act of the lawmaking power of the Nation to be in violation of that fundamental instrument upon which all the powers

> of the Government rest. This is particularly true of a revenue act of Congress. The provisions of such an act should not be lightly or unadvisedly set aside, although if they be plainly antagonistic to the Constitution it is the duty of the court to so declare. The power to tax is the one great power upon which the whole national fabric is based. It is as necessary to the existence and prosperity of a nation as is the air he breathes to the natural man. It is not only the power to destroy, but it is also the power to keep alive. * * * But while yielding implicit obedience to these constitutional requirements (Constitution, Art. I, sec. 8, and sec. 9, subdivisions 4 and 5) it is no part of the duty of this court to lessen, impede, or obstruct the exercise of the taxing power by merely abstruse and subtle distinctions as to the particular nature of a specified tax, where such distinction rests more upon the differing theories of political economists than upon the practical nature of the tax itself. (514, 515.)

In *Lindsley* v. *Natural Carbonic Gas Co., supra,* this court said:

> One who assails the classification in such a law must carry the burden of showing that it does not rest upon any reasonable basis but is essentially arbitrary. (78, 79.)

With our angle of view thus established, we now apply the test of the rule to the several exemptions and alleged discriminations here complained of.

A. The EXEMPTIONS (of $3,000 of the income of an individual and of the entire income of certain organizations and associations) were within the exempting power.

It is unnecessary to establish argumentatively the power to make either of these exemptions. This court said the final word in *Flint* v. *Stone-Tracy Co., supra,* as follows:

> It is again objected that incomes under $5,000 are exempted from the tax. It is only necessary, in this connection, to refer to *Knowlton* v. *Moore,* 178 U. S., *supra,* in which a tax upon inheritances in excess of $10,000 was sustained. In *Magoun* v. *Illinois Trust & Savings Bank,* 170 U. S. 283, 293, a graded inheritance tax was sustained. As to the objections that certain organizations, labor, agricultural and horticultural, paternal and benevolent societies, loan and building associations, and those for religious, charitable, or educational purposes, are exempted from the operation of the law, we find nothing in them to invalidate the tax. As we have had frequent occasion to say, the decisions of this court from an early date to the present time have emphasized the right of Congress to select the objects of excise taxation, and within this power to tax some and leave others untaxed, must be included the right to make exemptions such as are found in this act. (173.)

It is submitted that in view of the many cases of *property* taxation, of which *Home of the Friendless* v. *Rouse, Salt Co.* v. *East Saginaw,* and *Gibbons* v. *District of Columbia,* all *supra,* are typical

this court can not distinguish between the Corporation-Tax Act of 1909 and the Income-Tax Law of 1913. The power to tax at all (in the instant case given specifically by the Sixteenth Amendment) is the essential element, not the nature or character of the tax.

Moreover, if any distinction is to be made, it is submitted that it must be drawn in favor of the constitutionality of this statute, for if an income tax is to be withdrawn from the class of excises it must be withdrawn also from the operation of the rule of uniformity which applies only to such taxes.

It is significant that in the *Flint* case this court deliberately refused to follow the reasoning upon this question of exemptions of Mr. Justice Field in his concurring opinion in the *Pollock* case upon its first hearing. (157 U. S. 429, 591 et seq.) This opinion, which, while nominally concurring, canvassed a question upon which the court avowedly stood equally divided, is extensively quoted in several of appellants' briefs.

In *Knowlton* v. *Moore, supra,* this court, by the present Chief Justice, said:

> * * * taxes imposed with reference to the ability of the person upon whom the burden is placed to bear the same have been levied from the foundation of the Government. So, also, some authoritative thinkers and a number of economic writers contend that a progressive tax is more just and equal than a proportional one. In the absence

> of constitutional limitation the question whether it is or is not is legislative and not judicial. (109.)

The principle of exempting small incomes finds support in the cases in this court involving inheritance-tax statutes. Although some of the appellants here deny the analogy, this court has expressly recognized it. *Flint* v. *Stone-Tracy Co., supra,* 173.

The Income-Tax Act of New Zealand (1894) exempts $1,500; of Massachusetts (1902) $2,000; of South Carolina, (1912) $2,500; and of Oklahoma (1907) $3500; while the Federal act of 1894 carried an exemption of $4,000. In view of the dates of these different enactments and the utterances of Mr. Justice Harlan (*infra*) as to the then (1894) cost of living, together with the well-known increase in living cost that has taken place in the last 20 years, it can hardly be said that the present exemption of $3,000 is so large as to be unreasonable; much less that it is so arbitrary as to indicate prejudice or favoritism.

In *Peacock* v. *Pratt,* 121 Fed. 772, 777 the Ninth Circuit Court of Appeals considering the $1,000 special exemption in the Hawaiian income act, said:

> It (the power to make reasonable exemptions) has been upheld on grounds of enlightened public policy—a public policy which seeks to exclude from taxation the living expenses of the average family, and thus to enable the poor man to escape becoming a public burden. It rests upon the theory

> that the exemption results in ultimate benefit to the taxpayer, which compensates him for the additional burden of taxation which he is thereby called upon to bear. * * * *If the power to make exemptions be once conceded, the amount of the exemption is largely within the discretion of the legislature—a discretion which is not subject to review in the courts unless it be clearly shown to have been abused.* (777.)

Appellant in the *Thorne* case (p. 66) cites a decision of the Supreme Court of Hawaii, *Campbell* v. *Shaw*, 11 Haw. 112, holding an earlier statute of substantially the same tenor to be unconstitutional. Hawaii is in the Ninth Circuit and the Circuit Court of Appeals is the court of last resort in that circuit. Moreover, the act involved in the case is easily distinguished from that in the case at bar. The former exempted $2,000 upon all incomes up to $4,000 but required the man whose income was $4,001 to pay the tax on the full amount. The Territorial court noted that fact in its opinion when it said:

> But the statute in question does not exempt from taxation all incomes to the amount of $2,000, but imposes upon him who receives over $4,000 a year a tax of 1 per cent upon the whole amount, whereas the person whose income is less than $4,000 pays only on the excess of income over $2,000. It is well settled that the legislature has the power to classify objects of taxation, but it is equally well settled that selections can not

be made out of a class for taxation and others of the same class be exempted. (120, 121.)

Although the question of exemptions was not discussed in the main opinion, the views of Mr. Justice Harlan upon this point in his dissenting opinion in the *Pollock* case (158 U. S.) are illuminating. He says:

> In this connection, and as a ground for annulling the provisions taxing incomes, counsel for the appellant refers to the exemption of incomes that do not exceed $4,000. It is said that such an exemption is too large in amount. That may be conceded. But the court can not for that reason alone declare the exemption to be invalid. Every one, I take it, will concede that Congress, in taxing incomes, may rightfully allow an exemption in some amount. That was done in the income-tax laws of 1861 and in subsequent laws, and was never questioned. Such exemptions rest upon grounds of public policy, of which Congress must judge, and of which the court can not rightfully judge; and that determination can not be interfered with by the judicial branch of the Government, unless the exemption is of such a character and is so unreasonably large as to authorize the court to say that Congress, under the pretense merely of legislating for the general good, has put upon a few persons burdens that, by every principle of justice and under every sound view of taxation, ought to have been placed upon all or upon

the great mass of the people. *If the exemption had been placed at $1,500 or even $2,000, few, I think, would have contended that Congress, in so doing, had exceeded its powers. In view of the increased cost of living at this day, as compared with other times, the difference between either of those amounts and $4,000 is not so great as to justify the courts in striking down all of the income tax provisions.* The basis upon which such exemptions rest is that the general welfare requires that in taxing incomes, such exemption should be made as will fairly *cover the annual expenses of the average family, and thus prevent the members of such families becoming a charge upon the public.* The statute allows corporations, when making returns of their net profits or income, to deduct actual operating and business expenses. Upon like grounds, as I suppose, Congress exempted incomes under $4,000. (675–676.)

NOTE.—This point is asserted in the Brushaber and Stanton complaints, but not urged in the brief in either of these cases. It is discussed, only as to its first phase (the $3,000 exemption), in the Thorne brief, though raised in the complaint and assignments of error only in a general way, if at all.

B. The various alleged DISCRIMINATIONS were within the selecting and classifying power.

The following outline will be observed in discussion:

(1) *Discriminations against corporations, and classes of corporations.*

(*a*) In not allowing corporations $3,000 exemption, as in case of individuals.

(*b*) In requiring corporations but not individuals to pay the normal tax on corporate dividends.

(*c*) In requiring certain corporations to collect "at the source." Discussed in III, *infra.*)

(*d*) In allowing corporations generally to deduct only an arbitrary amount of interest paid on bonded indebtedness, while allowing banks to deduct all interest paid on deposits.

(*e*) In not allowing mining corporations to deduct only a certain portion of their ore depletion.

(2) *Discrimination in surtax provision.*

(*a*) In applying to individuals but not to corporations.

(*b*) In classifying on basis of wealth.

(*c*) In not allowing $3,000 exemption as in case of normal tax.

(*d*) In not allowing deduction of corporate dividends as in case of normal tax.

(*e*) In allowing corporations but not partnerships or individuals, to withhold profits from taxation.

(3) *Discrimination against individuals whose tax is withheld or paid at source.*

(*a*) Loss of use of money and of interest.

(*b*) Double payment in case where source pays but does not "withhold" because of "tax free" covenant. Source pays and individual must also pay and seek refund.

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(*c*) Double loss in case where source withholds but does not pay, individual being obliged to pay and lose twice amount of tax.

(4) *Discrimination against husband and wife living together, only one exemption of $4,000 being allowed in computing the normal tax, and the surtax being levied upon the excess above $20,000 of their aggregate incomes even if neither alone receives $20,000.*

(5) *Discrimination against the house renter in favor of the house owner.*

The argument advanced in the previous part of this division (I) of the brief completely disposes of all of the above alleged discriminations. Each is but an exercise by Congress of its discretion to select the objects of taxation and the details of incidence and operation. Congress having determined that recognized distinctions between individuals and partnerships on the one hand, and corporations on the other, justify separate classification, the courts may not say whether such determination is sound or even expedient. Assuming that Congress has taxed a house renter but failed to place an equal burden on the house owner, this is by no means an outrageous usurpation of power. It is but the exercise of a clearly defined power derived from each the Constitution and the Sixteenth Amendment.

Under protest, we nevertheless further consider severally the discriminations complained of.

(1) Discriminations against corporations and classes of corporations.

Broad fundamental distinctions *for the purposes of taxation* have been drawn between corporations and individuals. Text writers and courts have simply recognized economic conditions that are well understood by everyone.

Black, on Income Taxes, page 28, says:

> The substantial difference between the rights, privileges, duties, and business methods of corporations and those of individuals engaged in business has been thought to afford a reasonable basis for placing them in different classes, for the purposes of taxation. Hence an income-tax law can not be adjudged invalid, as making unjust or illegal discriminations, because it imposes a different rate of taxation upon the income of corporations from that imposed upon the income of individuals, or because it exempts the income of the individuals below a certain sum, but does not grant a similar exemption to corporations. (Citing cases.)

In *Flint* v. *Stone-Tracy Co,.* 220 U. S. 107, 158, this court, in construing the Corporation-Tax Law of 1909, said:

> But, it is insisted, this taxation is so unequal and arbitrary in the fact that it taxes a business when carried on by a corporation and exempts a similar business when carried on by a partnership or private individual as to place it beyond the authority conferred upon Congress. As we have seen,

the only limitation upon the authority conferred is uniformity in laying the tax, and uniformity does not require the equal application of the tax to all persons or corporations who may come within its operation, but is limited to geographical uniformity throughout the United States. This subject was fully discussed and set at rest in *Knowlton* v. *Moore*, 178 U. S. 41, *supra*, and we can add nothing to the discussion contained in that case.

And again at page 161 the court said:

* * * it could not be said, even if the principles of the Fourteenth Amendment were applicable to the present case, that there is no substantial difference between the carrying on of business by the corporations taxed and the same business when conducted by a private firm or individual. The thing taxed is not the mere dealing in merchandise, in which the actual transactions may be the same, whether conducted by individuals or corporations, but the tax is laid upon the privileges which exist in conducting business without the advantage which inhere in the corporate capacity of those taxed and which are not enjoyed by private firms or individuals. These advantages are obvious, and have led to the formation of such companies in nearly all branches of trade. The continuity of the business without interruption by death or dissolution, the transfer of property interests by the disposition of shares of stock. the advantage of

> business controlled and managed by corporate directors, the general absence of individual liability, these and other things inhere in the advantages of business thus conducted which do not exist when the same business is conducted by private individuals or partnerships.

It is true that the court was dealing in the *Flint* case with an excise tax. Nevertheless this quotation is controlling in the present discussion. The charge here is that any distinction between income of individuals and of corporations is without reason, merely arbitrary, and hence illegal. In the *Flint* case this court called attention to substantial differences between business of individuals and of corporations. Those differences existed in 1913 when this act was passed as truly as in 1909, when the Corporation-Tax Act was enacted, or in 1911 when the *Flint* case was decided. Its discretion in having classified a tax upon the basis of those differences is no more the subject of review in 1915 than it was in 1911. The only question is the broad general one, whether there is uniformity *among members of the same class.*

In *Nicol* v. *Ames,* supra, this court construed that provision of the so-called War Revenue Act of 1898, which levied a tax upon sales of property by boards of trade or exchanges. This court said:

> In searching for proper subjects of taxation to raise moneys for the support of the

> Government Congress must have the right to recognize the manner in which the business of the country is actually transacted; how, among other things, the exchange of commodities is effected, what facilities for the conduct of business exist; what is their nature and how they operate; and what, if any practical and recognizable distinction there may be between a transaction which is effected by means of using certain facilities, and one where such facilities are not availed of by the parties to the same kind of a transaction. Having the power to recognize these various facts, it must also follow that Congress is justified, if not compelled, in framing a statute relating to taxation, to legislate with direct reference to the existing conditions of trade and business throughout the whole country and to the manner in which they are carried on. (516.) * * * In our judgment a sale at an exchange does form a proper basis for a classification which excludes all sales made elsewhere from taxation. (521.)

This court has held that even in State taxation, where intrinsic personal uniformity is demanded by the "equal protection" clause, railroad corporations may be classified apart from individuals. *Kentucky Railroad Tax Cases,* 115 U. S. 321, 337, 339. And, further, that express companies may be classed separately from other corporations. *Pacific Express Co.* v. *Seibert,* 142 U. S. 339, 354.

Some of the intrinsic differences are well expressed by the Supreme Court of Wisconsin in *Income Tax Cases*, 148 Wis. 456, as follows:

> Much complaint is made of that part of sec. 1087m–6 which provides a different rate of taxation for the income of corporations from the rate prescribed for individuals, and this also is said to be unjust discrimination. Again the question is whether there be substantial difference of situation between individuals and corporations which suggest and justify this difference in treatment, and again it seems that the answer must be Yes. The corporation is an artificial creation of the State endowed with franchises and privileges of many kinds which the individual has not. * * * The corporate privileges which are exclusively held by corporations, and the real differences between the situation of a corporation and an individual, among which may be mentioned the fact that the corporation never is obliged to pay an inheritance tax, *plainly justify a difference of treatment in the levying of the income tax.*

In Wisconsin the " equal and uniform " clause applies to a tax on property. Viewing the income tax as an excise, the court relieved it of the uniformity test. The case is referred to only as demonstrating the distinctions which make such a classification fair and *reasonable.*

An application of the tests and doctrines formulated in the foregoing cases to the various alleged

discriminations against corporations and classes of corporations completely disposes of each objection; and we ought not, at this late day, to be required to discuss the right to classify corporations apart from individuals for purposes of taxation.

Pursuing a still more minute application of the principles just announced to the specific discriminations charged:

(a) Discrimination in not allowing corporations the $3,000 exemption allowed to individuals.

As matter of course, corporations were not given a $3,000 exemption. That exemption was intended to cover what the late Mr. Justice Harlan referred to in the portion of his dissenting opinion quoted above as "the annual expense of the average family." The corporation has no such annual expense, and it is allowed to deduct such expenses as it has under the heading "ordinary and necessary expenses," which, in turn, are *not* allowed to individuals. While it has an annual business expense, a corporation does not eat, drink, wear clothes, own a dwelling, raise a family, or purchase entertainment, and the special exemption is accorded the individual largely, if not wholly, upon the ground that if any portion of the wherewithal with which he maintains himself and family is taken away he is the more likely to become a public charge, thereby increasing instead of lightening the general tax burden.

NOTE.—This point is asserted in the Brushaber and Stanton complaints, but not discussed in the brief of either of those cases.

(b) Discrimination in requiring corporations and not individuals to pay tax on corporate dividends.

It has been held repeated by this court that the legislature may make a difference, for the purposes of taxation, between the capital stock of a corporation in the hands of the corporation itself and the shares of the same capital stock in the hands of the individual stockholders. *Tennessee* v. *Whitworth,* 117 U. S. 129; *New Orleans* v. *Citizens' Bank,* 167 U. S. 371. In the instant case the distinction between income in the hands of a corporation and of its individual stockholders is entirely analogous.

In the case of *Tennessee* v. *Whitworth, supra,* this court said:

> In corporations four elements of taxable value are sometimes found: 1, franchises; 2, capital stock in the hands of the corporation; 3, corporate property; and, 4, shares of the capital stock in the hands of the individual stockholders. Each of these is, under some circumstances, an appropriate subject of taxation; and *it is no doubt within the power of the State* when not restrained by constitutional limitations, *to assess taxes upon them in a way to subject the corporation or the stockholders to double taxation.* (136, 137.)

In *Powers* v. *Detroit & Grand Haven Ry.,* 201 U. S. 543, this court said:

> That a distinction exists between that which is the property of the several share-

> holders and subject to taxation as other property belonging to them, and that which is the property of the collective incorporated person we call a corporation, and subject to taxation as such, has been repeatedly pointed out. (559, 560.)

Appellant Brushaber seeks, at pages 25–27 of his brief, to show that the act instances "flagrant arbitrariness" in thus embodying what he calls "this legislative disapproval of holding companies." The attack is substantiated neither in reason nor in argument. It is one thing to decry oratorically legislative prejudice against holding companies. It is quite another matter (not attempted, but essential to substantiate his position) to show that holding companies do not present in and of themselves a basis for classification quite distinct from persons doing business in their individual capacity. In *Flint* v. *Stone-Tracy Co., supra,* distinguishing between individuals and corporations, this court said (p. 150) that "the difference * * * is not merely nominal" and held that legislative classifications setting the two apart are entirely reasonable and valid. Surely even greater differences exist between individuals and *holding companies.*

NOTE.—This point is asserted in the complaints and urged in the briefs of both the Brushaber and Stanton cases.

(c) In requiring certain corporations to collect "at the source."

Because this charge of discrimination (as between corporations thus burdened because of having a bonded indebtedness, and those not subject to

the provision for source collection) also involves an independent allegation of unconstitutionality as violating "due process" it will be discussed *in toto* under III, *infra.*

NOTE.—This point is asserted in the complaint and argued in the brief of the Brushaber case and no other.

(d) Discrimination in allowing corporations generally to deduct only an arbitrary amount of interest paid on bonded indebtedness, while allowing banks to deduct all interest paid on deposits.

The charge here is twofold: (1) Discrimination in favor of a corporation having a relatively small indebtedness and (2) in favor of banking, loan, and trust companies in respect to the provisions allowing the deduction of interest payments.

In the *Flint* case, *supra,* this court in expressly passing upon this question, said:

> Again it is urged that Congress exceeded its power in permitting a deduction to be made of interest payments only in case of interest paid by banks and trust companies on deposits, and interest actually paid within the year on its bonded or other indebtedness to an amount of such bonded and other indebtedness not exceeding the paid up capital stock of the corporation or company. This provision may have been inserted with a view to prevent corporations from issuing a large amount of bonds in excess of the paid-up capital stock, and thereby distributing profits so as to avoid the tax. *In any event we see no reason why this method of ascertaining the deductions allowed should invali-*

date the act. Such details are not wholly arbitrary and were deemed essential to practical operation. *Courts can not substitute their judgment for that of the legislature. In such matters a wide range of discretion is allowed.*

It is significant that the provisions of the Corporation-Tax Act of 1909 as to deduction of interest payments, both in the case of indebted corporations and of banks and trust companies, which were being construed by this court in the passage quoted, were in all material respects similar to the corresponding provisions of the Income Tax Act, to which exception is taken in these objections. Also it is to be remembered that in the *Flint* case, *supra,* before justifying the interest deductions of the act of 1909, this court had specifically found that the act applied to realty companies (pp. 169–171). In the instant case it is in connection with a realty company, i. e., in the *Tyee* case, No. 393, that the point of discrimination on account of interest deductions is most strongly urged.

NOTE.—This point is asserted in the Tyee and Brushaber complaints and urged in both briefs.

(e) Discrimination in allowing mining corporations to deduct only a certain portion of their ore depletion.

The special distinction here claimed rests on two grounds—(a) that in allowing mining, but not other corporations, a maximum deduction of 5 per cent "for depletion of ores and all other natural deposits" a tax is laid on *capital;* that this is not

justified by the Sixteenth Amendment and being a direct tax it must be apportioned; and (b), that a classification of mining corporations as against others, is purely arbitrary and rests upon no substantial distinction.

Appellant is apparently confused as to what the act provides. He asserts that all other corporations are entitled to deduct all losses, including all depletion of capital; while mining companies are permitted to deduct a small portion only of such depletion. The act, however, provides that "such corporations" (i. e., all corporations, *including mining,* that are liable to the tax) may deduct from their *gross* income

> all losses sustained within the year * * * including a reasonable allowance for depreciation by use, wear and tear of property, if any; *and,* in the case of mines, a reasonable allowance for depletion of ores and all other natural deposits, not to exceed, etc.

Mining companies therefore, as much as other corporations, are entitled to deduct all losses and a certain class of depreciation. *In addition,* they are permitted to deduct for depletion of capital, a privilege not extended to other corporations. Their complaint must be that to allow them only what is allowed to ordinary corporations is unjust, since their capital is embarked in a wasting business. Doubtless this was the controlling reason why Congress granted them a special 5 per cent additional.

It is difficult to see how they can have any standing in court as special objectors. *Flint* v. *Stone Tracy Co., supra* (177); *Southern Ry. Co.* v. *King,* 217 U. S. 534; *Hatch* v. *Reardon,* 204 U. S. 160.

The argument that the allowance of but a per cent of the depletion makes it a tax upon capital rests upon the fallacious theory that the Amendment operated to deprive Congress of the power to tax *gross* or any other than net income. Such a reading gives the Amendment a restrictive operation, for it will be conceded that if made uniform and properly apportioned Congress could have laid a tax upon gross income before the Amendment had it desired so to do, just as, under the form of an excise, it may lay a tax on gross receipts. The object of the Amendment, as the legislative history demonstrates, was to do away with the need for apportionment declared by the *Pollock* case, Cong. Rec., 60th Cong., 1st sess., vol. 44, pt. 4, pp. 4067, 4068, 4105–4121, 4364, 4390–4441, 4629; pt. 5, pp. App., 117, 119–121, 126, 127, 131, 132. Otherwise, it left the subject untouched. It had no purpose to narrow the power of Congress. On the contrary, it used the general word "income," and added *"from whatever source derived."* It was intended to grant the power to lay a tax without apportionment, not only on the particular kind of income, subject to the decision in the Pollock case and any other kind sought to be reached by the Act of 1894; but also any other kind of income, including all so

treated in the previous legislative action of either England or America. The old legislative phrase was "gains, profits, and income," and the latter word reached beyond either of the former, as it would not if it meant merely *net* income. If "income" meant *only* "net income," then the words "gross" and "net" would be idle terms.

While this act levies a tax on net income only, it is what may be called "statutory net income," in defining which Congress must be governed by practical considerations rather than economic definitions or theories. Thus in this act, inter alia, an individual may not deduct living expense, nor amounts paid for new buildings or permanent improvements; corporations may deduct but a portion of their interest paid; and insurance corporations are allowed peculiar deductions. The resultant statutory net income is a mere declaration by Congress of the amounts that may be deducted from gross income. This declaration is binding on the courts, unless it in some way offends against some of the express provisions of the Constitution relating to taxation.

Unless receipts from ores mined are not gross income the tax can not be objected to, even though mines be not entitled to deduct from gross income *all* their depletion of capital.

That the proceeds of ore mined and sold constitute gross income or gains from business operation has been settled by the case of *Stratton's Independence, Limited,* v. *Howbert,* 231 U. S. 399.

The second question certified to this court in that case was:

> 2. Are the proceeds of ores mined by a corporation from its own premises income within the meaning of the aforementioned act of Congress?

This court, speaking through Mr. Justice Pitney, answered this question affirmatively, and said:

> The sale outright of a mining property might be fairly described as a mere conversion of the capital from land into money. But when a company is digging pits, sinking shafts, tunneling, drifting, stoping, drilling, blasting, and hoisting ores it is employing capital and labor in transmuting a part of the realty into personalty, and putting it into marketable form. The very process of mining is, in a sense, equivalent in its results to a manufacturing process. And however the operation shall be described, the transaction is indubitably "business" within the fair meaning of the act of 1909; and the gains derived from it are properly and strictly the income from that business, for "income" may be defined as the gain derived from capital, from labor, or from both combined, and here we have combined operations of capital and labor. (414–415.)

The foregoing language applies with full force to like mining operations when viewed from the standpoint of the present act. True, it is said (p. 416) that it was not necessary for the purposes of the Corporation Tax Act that it should be such

income as would have been taxable as such. The court was referring to a tax on income as such in contradistinction to an excise and to the taxing power as it existed before the passage of the Sixteenth Amendment. At that time apportionment, under the *Pollock* decision, was necessary as to certain kinds of income, and as there was no apportionment provided in the Corporation Tax Act the court was disposing of that feature. It was dealing with the old power, and merely applied the well-settled rule that property itself not subject to taxation may be included in the standard of measure declared for an excise.

We now have a new statute, by its terms reaching all income "from whatever source derived" and all gains and profits from any kind of business whatever, and supported on a proper constitutional basis; and in determining whether the mining operation is "business" and the proceeds gained from ores are "gains from business" or "income" within the definition of the new act we must apply the very test, and determine the question upon the same considerations, that moved this court to that conclusion in the *Stratton* case.

It is true that, perhaps illogically, an *individual* sale of property by its owner or the *mere receipt* of a *debt* in installments is under certain statutes treated as being a conversion of capital from one form into another, and as consequently creating no income. *Foley* v. *Fletcher*, 3 H. & N. 769; *Secre-*

tary of State v. *Scoble,* 1903, A. C. 299; *Stevens* v. *Hudson's Bay Co.,* 101 L. T. Rep. 96; *Commonwealth* v. *Central Transportation Co.,* 145 Pa. St. 89, cited by counsel for appellant, and, perhaps, *Gray* v. *Darlington,* 15 Wall. 63, are illustrative. There is a reason for this holding, for such sporadic payments of large amounts will probably be reinvested, and pay an income tax in their new form. But such cases, it is agreed, have no application where the sales are made as part of a regular business, such as mining ore, etc. Farwell, L. J., in *Stevens* v. *Hudson's Bay Co., supra,* says:

> " * * * It is clear, therefore, that a man who sells his land or pictures or jewels is not chargeable with income tax on the purchase money or on the difference between the amount that he gave and the amount that he received for them. But if, instead of dealing with his property as owner, he embarks on a trade in which he uses that property for the purposes of his trade, then he becomes liable to pay not on the excess of sale prices over purchase prices, but on the annual profits or gains arising from such trade, in ascertaining which those prices will no doubt come into consideration. * * * "

And in *Gray* v. *Darlington, supra,* Mr. Justice Field distinguishes between a person who invests in bonds and later sells them at a profit and a person who engages in the business of buying and selling bonds, in which latter case the total receipts would have to be brought into income.

If the sales of the ore in the regular course of business are treated as *mere* conversions of capital, the State may lose its tax entirely; so also if a deduction be permitted of depletion of capital, since this may almost always be figured so as to equal the net income. Consequently the English courts have held under their acts that mining companies are not entitled to deduct anything for depletion of capital, *Coltness Iron Co.* v. *Black,* 6 App. Cas. 315; *Alianza C.* v. *Bell,* 1904, 2 K. B. 666; 1905, 1 K. B. 184; 1906, A. C. 18. It is claimed that these decisions turn on the peculiar language of the English acts. To this we do not assent, but assuming it to be true, nevertheless it appears from these authorities that both Parliament and the courts thought mines a peculiar form of investment, since they refused to allow them deductions which they allowed to other businesses. In the administration of the Civil War Income-Tax Act the Commissioner of Internal Revenue ruled that " no deduction can be made because of the diminished value, actual or supposed, of the coal vein or bed by the process of mining " (Boutwell on the Direct and Excise Tax System of the United States, pp. 273, 274); and apparently the ruling was never questioned. The same ruling was made in Pennsylvania under its income-tax act, *Commonwealth* v. *The Ocean Oil Co.,* 59 Pa. St. 61; *Commonwealth* v. *Penn. Gas Coal Co.,* 62 Pa. St. 241.

As to discrimination. If the separate classification of mining corporations as to deductions be

based upon any reasonable ground relating to revenue, this court will go no further. To demonstrate such ground, it is only necessary to elaborate the general argument already made. Mining companies have intentionally embarked their capital in an enterprise whose very end is to destroy that capital as a regular business, convert it annually into income, and distribute it as such. "It is capital converted by the deliberate act of its owner into income for the very purpose of being expended annually." No other business is exactly like this in the destruction, without replacement, of capital, and the distribution of it as profits. But, as said by this court in the *Stratton's Independence, Limited,* case, *supra,* p. 415:

> As to the alleged inequality of operation between mining corporations and others, it is of course true that the revenues derived from the working of mines result to some extent in the exhaustion of the capital. But the same is true of the earnings of the human brain and hand when unaided by capital, yet such earnings are commonly dealt with in legislation as income. So it may be said of many manufacturing corporations that are clearly subject to the act of 1909, especially of those that have to do with the production of patented articles; although it may be foretold from the beginning that the manufacture will be profitable only for a limited time, at the end of which the capital value of the plant must be subject to material depletion,

the annual gains of such corporations are certainly to be taken as income for the purpose of measuring the amount of the tax.

In the *Stratton* case, and in other cases tried in the lower courts it appeared that several different theories were entertained by mining experts as to the proper deduction to be allowed mining companies under the Corporation Tax Act. Some based it on the cost of the mine, others on the value per ton of the ore in place figured by different methods. Congress has wisely removed that uncertainty. Appellant Stanton presents an elaborate and difficult calculation (pp. 10 and 11 his brief) by aid of which he reaches the conclusion that one-half the company's net receipts after deducting operating expenses, losses, and depreciation from wear and tear, represents depletion of capital. Without pausing to analyze these figures, it is enough to say that they are " upon the basis of latent and occult intrinsic values," and not " upon considerations that affect market value and have their influence upon men of affairs charged with the management of the business and accounting of corporations that are organized for profit and are engaged in business for purposes of profit," (*Stratton's Independence, Limited,* p. 421.)

Such a plan might be appropriately urged upon Congress. But he may not in this court, substitute his own discretion for the right of selection belonging to Congress. This method is quite as arbitrary as that chosen by Congress.

Moreover, it would clearly be inapplicable to companies extracting stratified minerals, such as coal, clay or limestone, whose extent can be determined with substantial accuracy, and which are bought and sold in place in units of area, or percolating minerals, such as oil and gas, whose extent and quantity are incapable of ascertainment. To sustain the contention of the appellants would therefore be to multiply classifications, and not to diminish them.

Some method must be chosen. The power of choice lay with Congress—not with counsel or the court. It is clear that the *value* of the ore in place can not furnish a correct criterion as to the amount of the deduction. Theoretically what should be set off against " gross income " to produce " net " is " outgo;" that is, the disservices—as opposed to the services—which the capital has caused its owner. This " outgo " is not the value of the capital at the time the deduction is claimed, but its cost. Thus a merchant deducts from his yearly receipts the cost of his article, not its value. It is to be hoped that its value equals what he sells it for, and hence the value test would leave no net income for taxation. And this clearly appears when the merchant buys his goods in one year and sells them in the next. There he is charged with the total receipts as gross income, and is not permitted to deduct the cost, since it was not incurred during the taxing year. (See per Field, J., in *Gray* v. *Darlington,* 15 Wall. 63, 66.) It is clear, therefore, that, however correct

counsel's figures may be, they are based upon an entirely wrong principle.

These were the economic conditions relative to mining companies which Congress faced when this act was passed. Applying the legal principles controlling the power of classification and selection as heretofore developed in this brief, the conclusion follows that such distinctions as are here complained of are free from objection. See also *Ohio Tax Cases,* 232 U. S. 576, 590, 591, and *Southwestern Oil Company* v. *Texas,* 217 U. S. 114, 126, 127.

In the assignment of errors in the Stanton Record, complaint is made that the Act is void because retroactive, not, as charged in the other cases, because it taxed income received during the period between the ratification of the Sixteenth Amendment and the passage of the Act, but because of Section 4, Paragraph S of the law, which made all corporations subject, for the two months of 1913 *prior to the Amendment,* to the provisions of the superseded Corporation Tax Law of 1909. The point is not argued in the Stanton brief, probably because appellant had in the meantime seen the futility of the claim. For January and February of 1913 the tax imposed was avowedly an excise, and the measure of that excise could have been receipts for *any period,* whether past or future. It is asserted that the Act continued the old excise law *as to corporations other than mining companies without change,* whereas in the case of mining companies a new provision was inserted as to deduction

for ore depletion. This assertion is erroneous. The old act was not *continued*. A *new act* was passed, and, as to the two months preceding the Amendment, the tax imposed was professedly an excise. That in some features the *new* was the same as, and in other features different from, the *old* excise makes no difference. What we have said *supra* as to the basis for the distinctions made in the act as to the *income* tax applies equally, if not *a fortiori*, to the *excise*.

NOTE.—Point "e" is discussed in #359 (Stanton case).

(2) Discrimination in surtax provision.

(a) Discrimination in applying to individuals, but not to corporations.

Corporations pay the normal tax on *all* profits, and so these profits are not burdened with a second normal tax when received by stockholders in the form of dividends. *Per contra,* the stockholder pays the surtax on dividends received; and so the corporation does not pay a surtax on the profits from which they are derived. Thus the corporate gain, viewed as a fund, ultimately pays each the normal and the surtax only once. If the corporation paid the surtax the individual would not, as is now the case with the normal tax. The charge of double taxation is thus avoided—Congress having merely elected to affix to the corporate gain the *normal* tax while it was still in the hands of the corporation, and the surtax after it reached the individual stockholder.

NOTE.—This point is asserted in the complaints of the Stanton and Dodge cases, but urged only in the Dodge brief.

(b) Discrimination in classifying upon basis of wealth.

The ordinary system of indirect taxation *upon consumption* places upon the poor person a disproportionate share of the burden of governmental support. Income taxation tends to shift the burden upward. It is undeniable that the greater the income the greater the ease with which the payment of taxes is met. Even allowing for the normal inevitable increase in the "scale of living," he who has the larger income can the more easily shoulder the burden of increasing, as the amount of income increases, not merely the total tax, but also the rate of taxation. At least, Congress has in its discretion determined that the heavier burden can be carried more easily by the larger income and it is not for the courts to say that such classification is outrageous. What has been said *supra*, in relation to the $3,000 specific exemption, and especially in connection with graded inheritance taxes, disposes of the present contention.

This question must be regarded as settled by the *Magoun* case, *supra*, at pages 292, 293, and 296, and by the *Knowlton* case, *supra*, at page 109, if the graduated inheritance tax analogy is applicable, as it was held to be in the *Flint* case, *supra*.

NOTE.—This point is asserted in the Brushaber and Thorne complaints, but urged only in the Thorne brief.

(c) Discrimination in not allowing $3,000 exemption as in case of normal tax.

If, when properly read, the act produces this result, nevertheless the objection is not substantial.

As well argue that the $3,000 exemption should be allowed upon every $5,000 or $10,000 section of an individual's taxable property; that the taxpayer's annual expense allowance should be deducted over and over again upon each taxable division, however arbitrary, of his property. The tax is in reality nothing more than a continuation of the normal tax. It is a tax upon income in excess of $20,000. What may be called the starting point of income taxation, i. e., $3,000, has already been passed within the confines of the $20,000, which is exempted entirely from surtaxation. Not only is the $3,000 exempted, as in the case of the normal tax, but there is an *additional exemption* of $17,000. As well contend that the *normal* tax is unconstitutional because $20,000 is not taken as the starting point, as in the case of the surtax.

NOTE.—This point is asserted in the Brushaber complaint, but not urged in the brief.

(d) Discrimination in not allowing deduction of corporate dividends, as in case of normal tax.

Why should the surtax allow such a deduction? The corporation pays no surtax. The corporate dividends have not, therefore, responded previously to the surtax. The only reason that corporate dividends were relieved from the *normal* tax in the hands of individuals was that they had already paid the *normal* tax (to which the corporation is subject) in the hands of the corporation. As well argue that *all income* (not simply corporate dividends) having paid a *normal* tax, must be deducted from income to

be taxed additionally—in other words, that there can be no surtaxation.

NOTE.—This point is asserted in the Brushaber complaint, but not argued in his brief, probably because Brushaber has not shown that he will ever have to pay a surtax, and surtaxes do not fall upon corporations.

(e) Discrimination in allowing corporations, but not partnerships or individuals, to withhold part of their profits from taxation.

The alleged discrimination arises in connection with the clause of the surtax provision, subdivision 2 of paragraph A of the income-tax section, which reads:

> For the purpose of this additional tax the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits if divided or distributed, whether divided or distributed or not, of all corporations * * *, however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided and distributed; and the fact that any such corporation * * * is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business, shall be prima facie evidence of a fraudulent purpose to escape such tax. But the fact that the gains and profits have in any case been permitted to accumulate and become the surplus shall not be construed as evidence of a purpose to escape the said tax

> * * * unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business.

The objection is twofold: (1) On behalf of the individual thus taxed, and (2) on behalf of partnerships and individuals who, it is alleged, suffer discrimination in not being allowed so to withhold profits from taxation.

The first ground of objection, although not involving a charge of discrimination, because it requires only brief treatment, is discussed here, parenthetically.

Appellants in the Baker brief, *supra*, assert that such taxation is "so utterly absurd as to induce levity"; that the stockholder may *never receive* the profits; the surplus may be dissipated and a tax paid upon an alleged income which never materializes. The answer lies in the provisions of the paragraph detailed *supra*. Not *every* undistributed profit is taxed. The provision operates only in case of *fraudulent* evasion. This, alone, would justify the provision.

It is not, however, simply in the light of a penalty that the paragraph is to be justified. A corporation carrying a large surplus, thereby measurably increases its earning power. An undistributed surplus, available for reinvestment and for extension and improvement purposes, constitutes a very real corporate asset. The advantage is by no means

intangible or inconsiderable. To have levied a *surtax* upon stockholders based on all corporate profits, however accumulated or held and even though undivided (which the act has not done), would have worked no hardship. It becomes, at most, another instance of selection and classification and is founded upon real and reasonable distinctions. It may be here noted that the Internal-Revenue Act of July 14, 1870, imposed a tax for the year 1871 of 2½ per cent on all undivided profits of corporations accrued and earned and added to a surplus, contingent, or other fund. This act was construed in *Marquette, Houghton, and Ontonagon Railroad Company* v. *United States*, 123 U. S. 722.

The second objection, *supra*, is groundless. It is discussed in the Baker brief in the *Dodge-Brady* case, No. 213, only.

At page 18 of the Transcript of Record in the *Dodge-Brady* case, No. 213, appears the following:

> Plaintiffs are advised and respectfully submit that permitting corporations to *withhold from taxation* a portion of their gains and profits as a surplus for the needs and purposes of the business in which they are severally engaged and not permitting individuals and partnerships to do so is a discrimination against individuals and partnerships * * * etc.

See also page 12 of the record in the *Dodge-Osborn* case, No. 213, and the Baker brief, *supra*, pages 11, 14, and 15.

The provision in question does *not* accord to corporations any privilege of withholding gains and profits from the surtax, as appears from even a superficial reading thereof.

In the first place, *corporations are not subject* to the *surtax*. Hence this entire provision can have nothing whatever to do with corporations, as such. It deals alone with the surtax, and involves only *individuals*.

In the second place neither this provision nor any other of the act, allows a corporation or an individual to withhold from taxation any portion of its or his *income*. *Income* is taxed and can not escape taxation by being withheld in the hands of anyone, whether corporation, partnership or individual. And, normally, the act taxes nothing except *income*.

This paragraph of the act, however, provides that if an individual either organizes or uses a corporation fraudulently to avoid a *surtax*, to which he alone is liable, by withholding profits from distribution beyond the bona fide needs of the business, he must pay that surtax just as if his fraudulent plan had not been attempted.

Had these earnings been honestly distributed, the individual would have paid a surtax, but no normal tax, thereon. The surtax alone was evaded; and is alone to be imposed as a penalty. Throughout the act the surtax is confined to individuals. (Appellants concede, and otherwise complain of this.) This being so, the exempting clause reliev-

ing the individual stockholders from the surtax on undivided profits honestly withheld must also be confined to individuals.

Corporations and partnerships, like individuals, are taxed upon their entire income, whether distributed or not. It is only as to an individual, however, that the question of taxation of the undivided profits *from his corporate holdings* can ever arise. This provision punishes the fraud by taxing profits not distributed or received, regarding them, because of the fraud, as if constructively received. The penalty operates only against the individual fraudulently using the corporation. It can not operate either on individual or partnerships not related to such a fraud; and therefore the exemption from the penalty, *i. e.*, the privilege of withholding from taxation a reasonable amount of profits, in turn can not operate upon individuals or partnerships not thus fraudulently involved.

By this complaint individuals and partnerships are seeking an exemption from a penalty which never has been, and never can be, enforced against them.

True, section D of the act contains a provision as follows:

> *Provided further,* That any persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether

> divided or otherwise, shall be returned for taxation and the tax paid * * *, etc.

It is argued from the above that partnerships are taxed upon undivided profits. What of it? Corporations, partnerships, and individuals are all taxed upon profits not taken from the undertaking but allowed to remain in the business. The difficulty arises in the distinctions which exist in the respective characters of a partnership and a corporation. The partnership exists only as its individual members exist. The income of a partnership is returned and taxed not as such, but as the income of the individual members thereof. Undivided profits of a partnership are taxed in the hands of the individual partners, just as the undivided profits of a corporation are taxed in the hands of a corporation, and just as profits allowed by an individual to remain in his business are taxed in his hands. But, after taxing undivided profits of a corporation, in the hands of the corporation itself, the act, distinguishing between the corporate entity and that of the individual holder of the corporate stock, has said undivided profits shall, under certain circumstances, bear a *second* burden, to be endured by the stockholder. The distinction was not made between the partnership and the partner, either in the case of actual income or of undivided profits, because the same double entity does not exist. It is in connection only with this concept of double entity in the case of corporations that the

provision in question taxing undivided profits comes into operation.

NOTE.—This point is asserted in the complaint and argued in the brief in the Dodge case and no other.

(3) Discrimination against individuals whose tax is withheld or paid at source.

(a) Loss of use of money and of interest.

It is urged that the individual whose tax is withheld at the source loses the use of the money and interest thereon durnig the period between the withholding and the coming due of the tax. Congress might have made the entire tax payable *upon receipt* of the taxable income. In effect Congress has done this in respect to income from evidences of corporate and fiduciary indebtedness. The reasonableness and justification of the classification thus effected by Congress has been established, *supra*.

NOTE.—This point is asserted in the Brushaber complaint, but is not urged in his brief.

(b) Double payment in case where source pays but does not "withhold" because of "tax-free" covenant. Source pays and individual must also pay and seek refund.

Though raised in the Brushaber complaint, and probably saved in the Assignment of Errors, the point is not argued. This is not surprising. The Treasury Department has never exacted such double tax nor does the act contemplate it. The double taxation could not, in fact, result except through the stupidity or error of the individual taxpayer. Because not argued by appellant, the point is not further considered.

(c) Double loss in case where source withholds but does not pay, individual being obliged to pay and lose twice amount of tax.

This objection can not involve the validity of the act. The taxpayer may or may not be obliged ultimately to bear the burden of a double payment. If he is unable to recover the amount of the tax from his fiduciary agent withholding the amount and failing to pay it to the Government, the loss is owing not to any unconstitutional or invalid provision of the taxing statute, but to an ordinary failure in a contractual relationship. The fact that a servant sent to pay a tax absconds with the currency does not invalidate the taxing law. Nor does it matter that in the instant case Congress has designated the paying agent, while ordinarily the individual chooses his own servant.

NOTE.—This point is asserted in the Brushaber complaint, but not urged in his brief.

A somewhat analogous contention is urged in the Brushaber brief, and is here briefly disposed of. Appellant says that when a corporation pays interest in full upon its obligations without deduction for taxes, pursuant to a usual "tax-free" clause, the corporation must pay the tax upon that interest *even though* the obligee may be entitled to exemption because his income does not exceed $3,000, and the tax in reality not be due. We answer merely that the act, providing completely against the payment of any tax which is not due, indicates specifically all steps to be taken with due diligence toward the claiming of its exemptions. The burden com-

plained of, if endured, results simply from the fact that the obligor on the indebtedness has by contract placed itself in a position where it, instead of the obligee, has an interest to exercise that diligence and claim the exemption. That it does not take the necessary steps in that regard can not affect the rights of the Government to impose its tax.

(4) Discrimination against husband and wife living together, only one exemption of $4,000 being allowed in computing the normal tax, and the surtax being levied upon the excess above $20,000 of their aggregate income, even if neither alone receives $20,000.

The $3,000 exemption was designed to cover living expense. It is undeniable that the legislature in the exercise of its discretion may draw the distinction between the *separate maintenance* of two persons on the one hand and their *combined* maintenance at lesser cost on the other.

To the charge that the surtax is levied upon the excess above $20,000 of the *aggregate* income of husband and wife, even if neither alone receives $20,000, we answer, as in connection with (3), (b), *supra,* that we find no such provision in the act and there is no such practice in its administration. If each alone receives an income of $19,999.99 no surtax is levied upon either.

NOTE.—Point asserted in Brushaber complaint, but apparently abandoned in brief. Thorne brief discusses first phase, i. e., $4,000 limitation, although question does not appear to have been raised in complaint; hence not included in assignment of errors. Neither appellant Brushaber nor appellant Thorne may urge point, since neither has shown himself to be married and living with wife.

(5) Discrimination against the house renter in favor of the house owner.

The legislative power of selection and classification is not violated by such a distinction, if made. The act is as free from objection in this respect as it is in respect to the charge that it discriminates against him who buys his meat and groceries in the market place in favor of the farmer who eats the animal offspring and products raised on his farm. Both charges were incorporated into the bill in the Brushaber case, but appellant has not considered them worthy of discussion in his brief, probably because it is not shown in the record that he is a house-renter nor that he is not a farmer.

II.

THE TAX IS NOT AN INFRACTION OF THE GENERAL POWER OF THE STATES TO AUTHORIZE THE FORMATION OF CORPORATIONS AND JOINT STOCK COMPANIES.

Appellant Brushaber (his brief, pp. 21–23) urges that the taxing power of Congress is impliedly limited by an alleged absolute power of a State to determine forms and methods of property ownership therein, and incidentally to authorize the formation of corporations and determine what burdens shall attach to them and their franchises, and he insists that this tax, so far as it reaches such corporations, wrongfully interferes with such State power.

The counsel who prepared the Brushaber brief advanced a like contention as to interference with

State powers, to this court in his brief filed in the *Flint* case, *supra* (124). In deciding against the contention, this court, in that case, said:

> This proposition is rested upon the implied limitation upon the powers of national and State governments to take action which encroaches upon, or cripples the exercise of the exclusive power of sovereignty in the other. (152) * * * The inquiry in this connection is how far do the implied limitations upon the taxing power of the United States over objects which would otherwise be legitimate subjects of Federal taxation, withdraw them from the reach of the Federal Government in raising revenue because they are pursued under franchises which are the creation of the States. (153) * * * But this limitation has never been extended to the exclusion of the activities of a merely private business from the Federal taxing power, although the power to exercise them is derived from an act of incorporation by one of the States. We therefore reach the conclusion that the mere fact that the business taxed is done in pursuance of authority granted by a State in the creation of private corporations does not exempt it from the exercise of Federal authority to levy excise taxes upon such privileges. (158)

It is submitted that as the question is not one of uniformity, but one of implied general limitation upon the Federal taxing power, no distinction is to be drawn as between an excise and a direct tax, and

that there is no such implied restriction in the case of either.

NOTE.—Although this point is discussed in both the Brushaber and Tyee briefs, it does not appear that it was asserted in the complaint in either of those cases, nor saved by assignment.

III.

THE BURDEN OF "SOURCE COLLECTION" PLACED UPON CERTAIN CORPORATIONS DOES NOT VIOLATE THE CONSTITUTION.

The objection that *indebted corporations* are unjustly burdened with "collection at the source," and other objections growing out of the source-collection feature, are answered by the consideration that there is presumably a very substantial advantage gained by the corporation supported and financed "from the outside," and at least it is true that there is a very *real difference* between a corporation having an interest-paying indebtedness and one which is not thus organized. There is nothing arbitrary or whimsical about a classification based upon such a tangible and fundamental difference in character.

But further justification for placing upon certain corporations, and, indirectly, upon taxpayers holding interest-bearing securities, the burden of "collection at the source," is found in more fundamental considerations.

Benefit to the Government is the first consideration of the framers of a law exercising the power of taxation. Annoyance to the taxpayers and disturbance of business conditions are to be avoided, of

course, wherever possible, but from the very nature of taxation, involving sacrifice by the individual to the State, it is inevitable that sacrifices will result from its enforcement. The great outstanding fact pertinent to the present discussion is that other tax laws which have endeavored to reach incomes without resorting to collection at the source have failed to reach very large portions of profits actually earned which should have been available for revenue purposes. The experience of State governments has shown that about 10 per cent of the taxation upon income from invested money has been collected, where its deduction was not compelled at the time of payment. In *Bank* v. *Commonwealth*, 9 Wall. 353, 363, this court said:

> It is the only mode which certainly and without loss secures the collection of the tax; * * * and * * * the mode which experience has justified * * * as the most convenient and proper, etc.

See also *Home Savings Bank* v. *Des Moines*, 205 U. S. 503. The corporate indebtedness of this country is said to be in excess of $28,000,000,000. The amount of interest paid upon this indebtedness is easily ascertainable. Much of this through sheer inadvertence, some of it perhaps through dishonest motive, would escape taxation without the aid of source collection. Income is even more easily secreted than personal property. If one can easily hide the physical evidences of the principal debt, how much more effectively can one conceal the fact

that income is being received thereon. In Great Britain collection at the source is well established and accomplished by means of a much more complex and onerous procedure than is provided in our act of 1913.

It is urged that while this collection constitutes an expense and burden upon the withholding or collecting agency, it is not a tax which is covered into the Treasury and is therefore not an ultimate benefit to the Government. Such argument is fallacious. Every expenditure of time and effort, whether upon the part of the taxpayer or of the Government collector, produces its benefit to the Treasury not in the actual expenditure in the machinery of payment or collection but in the resulting inflow of revenue. As pointed out above, collection at the source saves to the Government vast amounts of revenue which would otherwise, for one reason or another, never be returned.

This is merely, after all, a question of degree. *Every taxing statute* places upon the taxpayer certain physical burdens in addition to the actual outlay of money. One is required to pay a tax at the office of the Collector of Internal Revenue. He may carry his payment to the office himself, or he may send his messenger. If he sends his messenger shall he be reimbursed for salary and carfare? The individual is required to make certain returns and computations upon blank forms furnished by the Treasury Department. If, instead of doing the

clerical work himself, he employs a secretary must he be compensated for the expenditure? The case is not dissimilar from the burden of "source" collection imposed upon certain corporations. If corporations are to be reimbursed for performing these labors, shall individuals also be compensated? Where shall application of the principle begin and end?

Moreover, after a short period of operation and actual experience the burdens complained of, whether on behalf of the corporate collector or the individual creditor, will be, and have been, considerably minimized. The expense of office assistance, the loss of interest, the inconvenience in negotiability, all these elements and numerous others which the ingenuity of counsel suggest will, through adjustment and regulation, be reduced to practically nothing.

Cooley, on Taxation, at page 832, 3d Ed., says:

> In a few cases, however, in which such a course could not work injustice, the State may reach the party taxed by indirection, and collect in the first instance from someone else, who in turn will become collector from the person on whom the tax is really imposed. The reason for this is, that in such cases it is more convenient to the State, and perhaps makes more certain the collection; and it could be resorted to only when the case is such that injustice could result to no one. A case of the kind is where a tax is imposed on the dividends or other receipts

> of shareholders from the profits of corporations, or upon their shares, or upon the interest paid by indebted corporations, and where the corporation is required to make the payment, which it would then deduct from the payment to be made to shareholders, or to the holders of the evidences of indebtedness. There is no doubt of the right to do this, except as to payments to be made to nonresidents. * * *

(The above deals with *State* taxation.)

And again, at page 34, the same author says:

> The legislature must therefore determine all questions of State necessity, discretion or policy involved, in ordering a tax and in apportioning it *must make all the necessary rules and regulations which are to be observed in order to produce the desired returns, and must decide upon the agencies by means of which collections shall be made.*

The passage last above quoted was cited with approval in *Patton* v. *Brady*, 184 U. S. 608, 620, 621.

In *Bell's Gap Railroad Co.* v. *Pennsylvania*, 134 U. S. 232 at page 239, this court said:

> The corporation, as the debtor of its bondholders, holding money in its hands for their use, namely, the interest to be paid, is merely required to pay to the Commonwealth out of this fund the proper tax due on the security. The tax is on the bondholder, not on the corporation. This plan is adopted as a matter of convenience and as a secure method of collecting the tax. That is all. It injures no

party. It certainly does not infringe the Constitution of the United States by making one party pay the debts and support the just burdens of another party, as is implied in the objection.

In *Cummings* v. *National Bank*, 101 U. S. 153, 156, this court, in holding valid a statute of Ohio which required the officers of the bank to report to the county officers the names and addresses of all stockholders, etc., said:

> In *National Bank* v. *Commonwealth*, 9 Wall. 353, we held that a statute of Kentucky, very much like this, which enabled the State to deal directly with the bank in regard to the tax on its stockholders was valid, and authorized a judgment against the bank which refused to pay the tax. It is true, the statute of Kentucky went further than the Ohio statute, by declaring that the bank *must* pay the tax, while the latter only says it may.

In *National Safe Deposit Co.* v. *Illinois*, 232 U. S. 58, 70, this court said:

> Nor was there any deprivation of property nor any arbitrary imposition of a liability in requiring the company to retain assets sufficient to pay the tax that might be due to the State. There are many instances in which, by statute, the amount of the tax due by one is to be reported and paid by another—as in the case of banks required to pay the tax on the shares of a stockholder. (*National Bank* v. *Commonwealth*, 9 Wall. 353, 363.)

Appellant Brushaber (his brief, p. 49) attempts to avoid the case just cited by the doctrine *de minimis*. Counsel state that an examination of the brief in said case shows that—

> it was not contended that the Illinois inheritance tax placed a financial burden on the safe deposit company nor was such situation passed upon by this court.

In the printed synopses of brief of defendants in error in that case (p. 65 of the Report) appears the following:

> The act does not make the safe deposit company an involuntary tax collector. (Cases cited.) Statutes have frequently required agents to return for taxation property in their possession and made such agents liable for the tax if they surrender the property without the tax thereon being paid. (Cases cited.)

It is submitted that in view of the foregoing and of the unequivocal language of this court in passing upon the points thus raised, this court can not be said to have been applying the doctrine of *de minimis* in the above case.

The underlying principle that a party in possession of property belonging to another may be compelled to pay in the latter's behalf the tax assessed thereon has been too frequently approved to be now disputed. See, in addition to the foregoing authorities, Gray on Limitations of the Taxing Power, sec. 1195 *et seq.*; *Aberdeen Bank* v. *Chehalis County,*

166 U. S. 440, 444; *Merchants' Bank* v. *Pennsylvania*, 167 U. S. 461, 465; *Carstairs* v. *Cochran*, 193 U. S. 10; *Union Bank* v. *City of Richmond*, 94 Va. 316; *Commonwealth* v. *Citizens' National Bank*, 117 Ky. 946.

NOTE.—This point is asserted in the Brushaber complaint and argued in his brief.

IV.

THE TAXATION OF INCOME ACCRUED PRIOR TO THE PASSAGE OF THE ACT VIOLATES NO CONSTITUTIONAL NOR EQUITABLE PRINCIPLE.

So much of the act as seeks to impose the tax upon *income received* and collected prior to the third day of October, 1913, the date of the passage of the act, is claimed to be unconstitutional. It is averred that the act is to that extent void, for the reason that it could not lawfully affect any receipts of the taxpayer accrued before its passage, because such receipts had become property and capital of the taxpayer and had ceased to be income. (Rec., p. 11.)

1. Former income-tax laws have contained the so-called "retroactive" feature.

Income tax laws, both in England and in the United States, have taxed income accrued prior to the date of enactment of the respective statutes. The point of unconstitutionality upon that ground has been raised repeatedly. The previous Federal income tax laws, to wit, the acts of August 5, 1861, 12 Stat. 292; July 1, 1862, 12 Stat. 473, 474; June

30, 1864, 13 Stat. 223, 281, 283; July 4, 1864, 13 Stat. 417; March 2, 1867, 14 Stat. 471, 478, 480; July 14, 1870, 16 Stat. 256; and August 27, 1894, 28 Stat. 553, s. 27, taxed income received prior to the passage of each act during periods respectively as follows: 1861, 7 months and 5 days; 1862 and June, 1864, 6 months; July, 1864, and 1867, 1 year; 1870, 6 months and 14 days; 1894, 7 months and 27 days.

English income-tax laws have provided, in respect to the period of taxation, as follows:

(1) Act of June 22, 1842, 5 and 6 Vict., c. 35, taxed income from April 5, 1842.

(2) Act of June 28, 1853, 16 and 17 Vict., c. 34, taxed income from April 5, 1853.

(3) Since 1861 the English taxing act has been reenacted annually, 16 Halsbury's Laws of England, 609, and has contained similar provisions.

Thus it appears that income tax legislation has from the beginning applied the principle here objected to. Indeed, the English acts have even carried the "*collection at the source*" back into periods and to cover payments antedating the passage of the statutes. Subsection 4 of Finance Act of 1910, *supra;* section 38 of Finance Act of 1894.

The constitutional question now raised could not, of course, arise in England. The parallel is significant only in this. England has maintained for almost a century a system of "income taxation." As a part of its system it has administered so-called

retroactive provisions, and the repeated process of measuring and taxing *receipts prior to the passage of the taxing statute,* has been known as the process of *taxing incomes.* The Sixteenth Amendment provides that Congress may levy and collect "*taxes on incomes,* from whatever source derived," without apportionment. Nothing appears against, and there is everything in favor of, the assumption that the Amendment used the term "*taxes on incomes,*" as the term had been applied and worked out in numberless statutes designating *income taxes* during the past century both in England and in the United States.

2. A period preceding the taxing year is a natural and easy measure of the tax, and whether or not income passes into the realm of capital is not material, for the tax need not attach to any "specific fund" of income, as such.

A nation or a State is confronted with the problem of levying and collecting additional taxes. In fairness, the burden should fall on those able to pay, and income, measured, not by what the taxpayer may receive during the *next succeeding* year, but by what he has received just prior to the taxing date, is the natural factor of determination. There is a present need for revenue. To wait a full calendar year after the passage of the tax law and then to consume a portion of another year in establishing a period for assessment, levy, and collection would not meet that need. The income for the

year preceding becomes the most available measure of the taxpayer's ability to pay.

In this view, it matters not whether income received prior to the passage of the act has become "property." None the less, it may constitute the measure of the tax assessed upon the taxpayer's estate.

The assertion that the act is unconstitutional because it taxes income which had become capital before the passage of the act necessarily involves the concept that taxable income constitutes a *specific fund* out of which the tax is taken, and that if the statute fails to place upon that fund at least a constructive notice of intention to collect the tax, the fund thus escapes the burden, passes into the classification of capital and becomes immune. Appellant Brushaber (brief, p., 72) argues that a power to tax income can be exercised only by taxing it at the moment when it comes in, and that immediately upon its receipt income loses its distinctive character as such and becomes part of the *corpus* and capital of an estate.

Taxable net incomes can not be determined until a balance can be struck at the end of a specific period. Allowable deductions may appear in the taxpayer's account during the last hours of the taxing year, and a gross income, which up to that time had appeared taxable, entirely escape the burden. The tax, when actually ascertained, is assessable against the whole estate of the taxpayer.

There is neither an actual nor a constructive carving of the tax out of any fund identified as income, nor can collection of the tax, once it is assessed, be defeated by any disposition of the income, either by investment, theft, or destruction. It is enough that it was received as income during the period chosen for the laying of the tax.

In *Drexel* v. *Commonwealth*, 46 Pa. St. 31, the Pennsylvania court said (p. 40):

> The English income tax and the United States income tax are based upon the incomes received in preceding years. The present United States income tax is laid upon the income of 1862, and the act of Congress for the 5th of August, 1861, 12 Stat. L. 309, expressly declares that "the tax herein provided shall be assessed upon the annual income of the persons hereinafter named for the year next preceding the 1st of January, 1862." * * *
>
> It is clearly, therefore, perfectly constitutional as well as expedient, in levying a tax upon profits or income, to take as the measure of taxation the profits or income of a preceding year. To tax is legal, and to assume as a standard the transactions immediately prior is certainly not unreasonable, particularly when we find it always adopted in exactly similar cases.

Although applied to statutory conditions somewhat dissimilar to those involved in the Income Tax Law of 1913, the following language of this court in

Stockdale v. *Insurance Companies,* 20 Wall. 323, 331, 332, has an important bearing upon this point:

> The right of Congress to have imposed this tax by a new statute, although the measure of it was governed by the income of the past year, can not be doubted; much less can it be doubted that it could impose such a tax on the income of the current year, though part of that year had elapsed when the statute was passed. * * *

Even in the dissenting opinion in the above case, it is said (p. 341):

> Of course I am not to be understood as maintaining that when the declaratory act was passed Congress had no power to impose a tax upon any income that had been received before that time.

3. That so-called "retroactive" features do not violate the Constitution has been held decisively.

In the *Wisconsin Income Tax Cases,* 148 Wis. 456, the court said:

> One further objection *we overrule here without comment, for the reason that it seems very unsubstantial,* namely, that the law is retrospective and void, because assessed on incomes received during the entire year 1911, while it did not go into effect until July 15th of that year, and also because it includes profits derived from the sale of property purchased at any time within three years previously.

Cooley on Taxation, 3d Ed. pp. 492, 493, and 494, says:

> Unless the constitution prohibits retrospective legislation the basis of an assessment of taxes may as lawfully be retrospective as the reverse; that is to say, it may as well have regard to benefits theretofore received as to those which may be received thereafter. * * * Nor in apportioning the tax between individuals is there any valid objection to making it on consideration of a state of things that may now have come to an end; as where a tax is imposed on the extent of one's business for the preceding year instead of upon an estimate of the business for the year to come. *Drexel* v. *Commonwealth*, 46 Pa. St. 31, * * * One may be taxed upon property which he has long ceased to own when the tax is levied.

Appellant Brushaber (his brief, p. 76) urges that the above case can have no bearing upon the construction of the Sixteenth Amendment, which did not then exist; that the court attached more weight to the general acquiescence in "war taxes" on patriotic grounds than would now be considered proper; and further, that the statute which the court was construing did not impose a new tax *ab initio*, but merely declared the construction of a prior statute. The court said:

> The right of Congress to have imposed this tax by a new statute * * * can not be doubted.

Plainer language could not be found.

See also *Locke* v. *New Orleans*, 4 Wall. 172; *Gray* v. *Darlington*, 15 Wall. 63, 66; *Maine* v. *Grand Trunk Ry. Co.*, 142 U. S. 217; *Patton* v. *Brady*, 184 U. S. 608; *Flint* v. *Stone-Tracy Co.*, 220 U. S. 108.

NOTE.—This point is asserted in the complaints in the Brushaber, Thorne, and Tyee cases, and is argued in the briefs in all of them.

V.

THERE IS NO INVALID DELEGATION OF JUDICIAL AUTHORITY TO THE SECRETARY OF THE TREASURY.

It is said that the act is invalid in delegating to the Secretary of the Treasury power to decide, in certain cases, that the accumulation as surplus of the undistributed profits of a corporation constitutes prima facie evidence of a fraudulent purpose to escape the tax.

The Secretary investigates, reaches a conclusion of fact, and certifies thereto. He simply exercises an administrative function; a judicial power is in no sense involved. Taxing officers are constantly invested with such power and the right to bestow it upon them is set at rest by the following cases: *Murray's Lessees* v. *Hoboken Land Co.*, 18 How. 272; *Fong Yeu Ting* v. *United States*, 149 U. S. 698, 714; *Lem Moon Sing* v. *United States*, 158 U. S. 538, 544; *Nishimura Ekiu* v. *United States*, 142 U. S. 651, 660; *United States* v. *Duell*, 172 U. S. 576, 586; *Butterworth* v. *Hoe*, 112 U. S. 50, 67; *Runkle* v. *United States*, 122 U. S. 543, 557; *United States* v. *Ju Toy*, 198 U. S. 253; *Tang Tun* v. *Edsell*, 223 U. S. 673; *United States* v. *Sing Tuck*, 194

U. S. 161, 170; *Japanese Immigrant Case*, 189 U. S 86, 98; *Turner* v. *Williams*, 194 U. S. 279; *Chin Bak Kan* v. *United States*, 186 U. S. 193; *Fok Yung Yo* v. *United States*, 185 U. S. 296; *Union Bridge Co.* v. *United States*, 204 U. S. 364, 386; *Buttfield* v. *Stranahan*, 192 U. S. 470; *Oceanic Steam Navigation Co.* v. *Stranahan*, 214 U. S. 320.

NOTE.—Point asserted in Brushaber complaint; not argued in brief. Also touched on in Dodge brief, in discussing withholding corporate profits from taxation; but not asserted in complaint nor saved specifically in assignment. Neither Brushaber nor Dodge may raise the question. Neither has shown exercise of alleged "judicial power" in his case, or interest in any fraudulent corporation.

VI.

THERE IS AMPLE PROVISION FOR HEARING AND APPEAL UPON MATTER OF ASSESSSMENT.

It is said that the act is invalid because it permits the Commissioner to make assessments without first giving notice of the intended assessment and opportunity to be heard thereon, *Dodge* v. *Brady*, Record, page 10. Division L of the act (quoted p. 3 this brief) adopted all general statutes providing appeals from tax assessments.

One of these statutes (sec. 3220, R. S.) provides that

> The Commissioner of Internal Revenue, subject to regulations prescribed by the Secretary of the Treasury, is authorized, on appeal to him made, to remit, refund, and pay back all taxes erroneously or illegally assessed or collected.

The claim that the statute does not apply where the assessments are not within the jurisdiction of the officer has been fully answered under the heading "Jurisdiction" of this brief.

Of all the internal revenue statutes, only two have contained provisions for notice and hearing before assessment. (Revised Statutes, section 3309a, relating to deficiency assessments against distillers of fruit brandy, and Revised Statutes, section 3371, providing assessment for omitted returns on tobacco.) Both statutes instance deficiency assessments and establish no rule for the making of regular assessments upon the basis of returns *made by the taxpayers themselves.* No necessity appears for granting notice and hearing before assessment when the return of taxable property emanates from the individual himself and the assessment issues upon that return.

In cases Nos. 213 and 396 the taxpayers made voluntary returns as required by the statute; were notified of the assessments as soon as made thereon; and thereafter filed with the Commissioner an appeal for remission of the surtax.

In *Kentucky Railroad Cases,* 115 U. S. 321, 331, 332, 333, this court said:

> It has, however, been repeatedly decided by this court that the proceedings to raise the public revenue by levy and collecting taxes are not necessarily judicial, and that "due process of law" as applied to that subject does not imply or require the right to

> such notice and hearing as are considered to be essential to the validity of the proceedings and judgments of the judicial tribunals. Notice by statute is generally the only notice given and that has been held sufficient * * * . In its application to proceedings for the levy and collection of taxes it was said in *McMillan* v. *Anderson*, 95 U. S. 37, 42, that it "is not and never has been considered necessary to the validity of a tax" "that the party charged should have been present or had an opportunity to be present in some tribunal *when he was assessed.*" * * * In the proceedings questioned in these cases there was in fact and in law notice and a hearing. The railroad company, by its president or chief officer, is required by law in a specified time to return to the Auditor of Public Accounts, under oath, a statement * * * . This return made by the corporation, through its officers, is the statement of its own case * * * . It is laid by the auditor * * * before the Board of Railroad Commissioners and constitutes the matter on which they are to act * * * .

People's National Bank v. *Marye*, 107 Fed. 570, involved a statute imposing a tax upon bank stock in the hands of individuals and requiring each bank to make a return to the Commissioner, giving the names of stockholders, number of shares held, its market value, etc. The court said:

> A careful inspection of the act shows that the assessor performs no judicial act in what he does, the fair interpretation being that the

> assessment made by him is upon the market value of the stock *as reported to him by the bank, and the act itself fixes the amount of the tax;* and under this view further notice to the taxpayer of the assessment is not required. * * * (580.)

In *Hagar* v. *District,* 111 U. S. 701, 709, it was said:

> Of the different kinds of taxes which the State may impose there is a vast number of which, from their nature, no notice can be given to the taxpayer, nor would notice be of any possible advantage to him. * * * Yet there can be no question that the proceeding is due process of law, as there is no inquiry into the weight of evidence or other element of a judicial nature, and nothing could be changed by hearing the taxpayer. No right of his is therefore invaded.

See also *Pittsburg, etc., R. R.* v. *Board of Public Works,* 172 U. S. 32, 45; *Turpin* v. *Lemon,* 187 U. S. 51, 58; *Glidden* v. *Harrington,* 189 U. S. 255, 258; and *Hodge* v. *Muscatine County,* 196 U. S. 276, 281.

In case the collector is dissatisfied with the taxpayer's return, the act requires him, before *increasing* amounts therein, to notify the taxpayer and afford him an opportunity to be heard; with right of speedy appeal to the Commissioner in the event of increase. (Subdivision d.)

Security Trust Co. v. Lexington, 203 U. S. 323, relied upon in the Dodge-Brady brief, well illus-

trates the distinction, since it involved a statute providing for a special assessment *for back taxes.*

Finally, it is objected that the present law places upon the Commissioner himself the duty of making assessments, thereby neutralizing whatever right of appeal to said official may otherwise have been reserved under the general tax statutes. In answer to this objection it need only be pointed out that by the Revised Statutes said official is *required* to make the assessments under *all internal revenue acts.* (Sec. 3182, R. S.) So that if appellants are correct in their contention all Federal tax laws since 1872, to which sec. 3182, R. S. is applicable, are likewise unconstitutional.

NOTE.—This point is asserted in the complaint in the Dodge case, and urged in their brief.

VII.

THE INVALIDITY OF A PART OF THE ACT WOULD NOT INVALIDATE THE WHOLE.

It is alleged in the Brushaber bill (R. 24) (but not urged in his brief) that the Income Tax Law constitutes "one entire independent system of taxation," and that the invalidity of any provision or portion must be held to invalidate the entire act. Inasmuch as he has argued a point (discussed below) closely allied thereto—i. e., the invalidity of the entire assessment if a part shall be held invalid—the two questions, though distinct, are treated under a single caption.

1. Invalidity of a part does not invalidate the entire statute.

Even though, in respect to any particular objection, this court should find that Congress had exceeded its authority, nevertheless the act should, if possible, be sustained in all other respects.

The rule that, unless it *can not be presumed* that Congress would have legislated for the valid portions, even though it had been advised in advance of the invalidity of a part of a statute, the valid portions must stand, is too well known to require more than mere statement.

> *Cooley,* Constitutional Limitation, 7th ed. pp. 246, 247, 250.
>
> *Field* v. *Clark,* 143 U. S. 649.
>
> *Huntington* v. *Worthen,* 120 U. S. 97.

2. The Income-Tax Act SPECIFICALLY PROVIDES that the finding that a portion of the act is unconstitutional or void shall not invalidate the entire act.

The act of October 3, 1913, does not leave us to speculate upon the legislative will in this particular. Section 4, paragraph T, of the act of which the income-tax provision constitutes Section II, provides that:

> If any clause, sentence, paragraph, or part of this act shall for any reason be adjudged by any court of competent jurisdiction to be invalid, such judgment shall not affect, impair, or invalidate the remainder of said act, but shall be confined in its operation to the clause, sentence, paragraph, or part thereof,

directly involved in the controversy in which such judgment shall have been rendered.

No room, therefore, exists for doubt as to the legislative intent, which, as indicated in the cases above, is the chief if not the sole criterion.

3. Position of appellant, Brushaber, that the invalidity of a portion of the assessment (covering income for period prior to passage of the act) renders entire assessment for 1913 invalid, is untenable because (1) no assessment is before this court in this record and (2) none could be considered in that case.

The fifth point of appellant's brief (pp. 77 to 81) argues and cites cases to the effect that:

> Where * * * *no method appears whereby the legal element can be separated from that which is illegal,* the whole tax or the whole assessment, as the case may be, is void. [Italics ours.]

Appellant, Brushaber, may not in his case inquire whether the assessment showed the illegal portion separably from the valid portion. There *was no assessment* in his case. There is not the slightest reference in the record to any assessment actually made under the Income Tax Law against the Union Pacific Railroad Company or any other person for the year 1913, or for any period. Appellant at page 78 of his brief says:

> It will not, we think, be disputed by the Government that during the pendency of this suit (that) the commissioner did make an assessment upon the income of the de-

> fendant for the whole period of 10 months from March 1, 1913, to December 31, 1913, inclusive, without distinguishing in the assessment between the period preceding and that following October 3, 1913, and without any evidence as to the receipt of income by the defendant after October 3, 1913. This, we submit, makes the entire assessment for the year 1913 void and entitles the plaintiff to an injunction restraining the defendant from paying any part of the tax assessed for the said year.

There is nothing in the record supporting the statement of appellant—

(1) That an assessment was made,

(2) That it did not distinguish between the period preceding and that following October 3, 1913, and,

(3) That there was no evidence as to the receipt of income by the defendant after October 3, 1913.

This court has not, therefore, any basis of fact to which to apply the rule announced by Mr. Justice Harlan in the *Santa Clara County* case, cited by counsel for appellant in support of the fifth point of the brief.

Moreover, the matters stated in the Brushaber brief, as above, all transpired *after* the bill was filed in his case; and appellant made no attempt, by supplemental bill, to advance objection to any *particular* assessment. Indeed he could not have successfully done so. The theory of his bill was that no valid assessment could be made under the act upon any evidence, and because thereof he applied to the

court to prevent his directors from exercising a business discretion to pay the tax. This is a cause of action entirely apart from a complaint of non-separation of alleged invalid portion of an otherwise valid assessment made under authority of law.

The point is, however, properly presented in the Thorne and Tyee cases and argued by reference to the Brushaber brief.

CONCLUSION.

The decrees and judgments should be affirmed in all the cases.

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OCTOBER, 1915.

APPENDIX.

INCOME TAX LAW.

[Section 2, act October 3, 1913; 38 Stat., 166 et seq.]

Normal tax, how levied.

A. Subdivision 1. That there shall be levied, assessed, collected and paid annually upon the entire net income arising or accruing from all sources in the preceding calendar year to every citizen of the United States, whether residing at home or abroad, and to every person residing in the United States, though not a citizen thereof, a tax of 1 per centum per annum upon such income, except as hereinafter provided; and a like tax shall be assessed, levied, collected, and paid annually upon the entire net income from all property owned and of every business, trade, or profession carried on in the United States by persons residing elsewhere.

Additional tax on net incomes in excess of $20,000.

Subdivision 2. In addition to the income tax provided under this section (herein referred to as the normal income tax) there shall be levied, assessed, and collected upon the net income of every individual an additional income tax (herein referred to as the additional tax) of 1 per centum per annum upon the amount by which the total net income exceeds $20,000 and does not exceed $50,000, and 2 per centum per annum upon the amount by which the total net income exceeds $50,000 and does not exceed $75,000, 3 per centum per annum upon the amount by which the total net income exceeds $75,000 and does not exceed $100,000, 4 per centum per annum upon the amount by which the total net income exceeds $100,000 and does not exceed $250,000, 5 per centum per annum upon the amount by which the total net income exceeds $250,000 and does not exceed $500,000, and 6 per centum per annum upon the amount by which the total net income exceeds $500,000. All the provisions of this section relating to individuals who are

chargeable with the normal income tax, so far as they are applicable and are not inconsistent with this subdivision of paragraph A, shall apply to the levy, assessment, and collection of the additional tax imposed under this section. Every person subject to this additional tax shall, for the purpose of its assessment and collection, make a personal return of his total net income from all sources, corporate or otherwise, for the preceding calendar year, under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury. For the purpose of this additional tax the taxable income of any individual shall embrace the share to which he would be entitled of the gains and profits, if divided or distributed, whether divided or distributed or not, of all corporations, joint-stock companies, or associations however created or organized, formed or fraudulently availed of for the purpose of preventing the imposition of such tax through the medium of permitting such gains and profits to accumulate instead of being divided or distributed; and the fact that any such corporation, joint-stock company, or association, is a mere holding company, or that the gains and profits are permitted to accumulate beyond the reasonable needs of the business shall be prima facie evidence of a fraudulent purpose to escape such tax; but the fact that the gains and profits are in any case permitted to accumulate and become surplus shall not be construed as evidence of a purpose to escape the said tax in such case unless the Secretary of the Treasury shall certify that in his opinion such accumulation is unreasonable for the purposes of the business. When requested by the Commissioner of Internal Revenue, or any district collector of internal revenue, such corporation, joint-stock company, or association shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same if distributed.

Personal return of net income to be made annually.

Interest in gains and profits of corporations to be included.

Accumulated gains and profits beyond needs, how regarded.

B. That, subject only to such exemptions and deductions as are hereinafter allowed, the net income of a taxable person shall include gains, profits, and income

Net income, items constituting same.

derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid, or from professions, vocations, businesses, trade, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in real or personal property, also from interest, rent, dividends, securities, or the transaction of any lawful business carried on for gain or profit, or gains or profits and income derived from any source whatever, including the income from but not the value of property acquired by gift, bequest, devise, or descent: *Provided*, That the proceeds of life insurance policies paid upon the death of the person insured or payments made by or credited to the insured, on life insurance, endowment, or annuity contracts, upon the return thereof to the insured at the maturity of the term mentioned in the contract, or upon surrender of contract, shall not be included as income.

Property acquired by gift, etc., and life insurance paid or allowed, exempt.

That in computing net income for the purpose of the normal tax there shall be allowed as deductions: First, the necessary expenses actually paid in carrying on any business, not including personal, living, or family expenses; second, all interest paid within the year by a taxable person on indebtedness; third, all national, State, county, school, and municipal taxes paid within the year, not including those assessed against local benefits; fourth, losses actually sustained during the year, incurred in trade or arising from fires, storms, or shipwreck, and not compensated for by insurance or otherwise; fifth, debts due to the taxpayer actually ascertained to be worthless and charged off within the year; sixth, a reasonable allowance for the exhaustion, wear and tear of property arising out of its use or employment in the business, not to exceed, in the case of mines, 5 per centum of the gross value at the mine of the output for the year for which the computation is made, but no deduction shall be made for any amount of expense of restoring property or making good the exhaustion thereof for which an allowance is or has been made: *Provided*, That no deduction shall be allowed for any amount paid out

Deductions allowed in computing net income for the purpose of the normal tax.

for new buildings, permanent improvements, or betterments, made to increase the value of any property or estate; seventh, the amount received as dividends upon the stock or from the net earnings of any corporation, joint stock company, association, or insurance company which is taxable upon its net income as hereinafter provided; eighth, the amount of income, the tax upon which has been paid or withheld for payment at the source of the income, under the provisions of this section, provided that whenever the tax upon the income of a person is required to be withheld and paid at the source as hereinafter required, if such annual income does not exceed the sum of $3,000 or is not fixed or certain, or is indefinite, or irregular as to amount or time of accrual, the same shall not be deducted in the personal return of such person.

Net income of nonresidents, from property owned in United States.

The net income from property owned and business carried on in the United States by persons residing elsewhere shall be computed upon the basis prescribed in this paragraph and that part of paragraph G of this section relating to the computation of the net income of corporations, joint-stock and insurance companies, organized, created, or existing under the laws of foreign countries, in so far as applicable.

Interest on obligations of State or of United States and compensation of certain U. S. officers exempt from tax.

That in computing net income under this section there shall be excluded the interest upon the obligations of a State or any political subdivision thereof, and upon the obligations of the United States or its possessions; also the compensation of the present President of the United States during the term for which he has been elected, and of the judges of the supreme and inferior courts of the United States now in office, and the compensation of all officers and employees of a State or any political subdivision thereof except when such compensation is paid by the United States Government.

Deduction of $3,000 allowed each single person, and $1,000 additional for married man and wife living together.

C. That there shall be deducted from the amount of the net income of each of said persons, ascertained as provided herein, the sum of $3,000, plus $1,000 additional if the person making the return be a married man with a wife living with him, or plus the sum of $1,000 additional if the person making the return be a married woman with

a husband living with her; but in no event shall this additional exemption of $1,000 be deducted by both a husband and a wife: *Provided*, That only one deduction of $4,000 shall be made from the aggregate income of both husband and wife when living together.

Period for which tax is to be computed.

D. The said tax shall be computed upon the remainder of said net income of each person subject thereto, accruing during each preceding calendar year ending December thirty-first: *Proviaed, however*, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be computed on the net income accruing from March first to December thirty-first, nineteen hundred and thirteen, both dates inclusive, after deducting five-sixths only of the specific exemptions and deductions herein provided for. On or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, a true and accurate return, under oath or affirmation, shall be made by each person of lawful age, except as hereinafter provided, subject to the tax imposed by this section, and having a net income of $3,000 or over for the taxable year, to the collector of internal revenue for the district in which such person resides or has his principal place of business, or, in the case of a person residing in a foreign country, in the place where his principal business is carried on within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, setting forth specifically the gross amount of income from all separate sources and from the total thereof, deducting the aggregate items or expenses and allowance herein authorized; guardians, trustees, executors, administrators, agents, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals: *Provided*, That a return made by one of two or more joint guardians, trustees, executors, administrators, agents,

Return to be made under oath by each person having a net income of $3,000 or over.

Gross income from all sources to be specified.

Guardians, trustees, etc., to make return for persons for whom they act.

receivers, and conservators, or other persons acting in a fiduciary capacity, filed in the district where such person resides, or in the district where the will or other instrument under which he acts is recorded, under such regulations as the Secretary of the Treasury may prescribe, shall be a sufficient compliance with the requirements of this paragraph: and also all persons, firms, companies, copartnerships, corporations, joint-stock companies or associations, and insurance companies, except as hereinafter provided, in whatever capacity acting, having the control, receipt, disposal, or payment of fixed or determinable annual or periodical gains, profits, and income of another person subject to tax, shall in behalf of such person deduct and withhold from the payment an amount equivalent to the normal income tax upon the same and make and render a return, as aforesaid, but separate and distinct, of the portion of the income of each person from which the normal tax has been thus withheld, and containing also the name and address of such person or stating that the name and address or the address, as the case may be, are unknown: *Provided*, That the provision requiring the normal tax of individuals to be withheld at the source of the income shall not be construed to require any of such tax to be withheld prior to the first day of November, nineteen hundred and thirteen: *Provided further*, That in either case above mentioned no return of income not exceeding $3,000 shall be required: *Provided further*, That any persons carrying on business in partnership shall be liable for income tax only in their individual capacity, and the share of the profits of a partnership to which any taxable partner would be entitled if the same were divided, whether divided or otherwise, shall be returned for taxation and the tax paid, under the provisions of this section, and any such firm, when requested by the Commissioner of Internal Revenue, or any district collector, shall forward to him a correct statement of such profits and the names of the individuals who would be entitled to the same, if distributed: *Provided further*, That persons liable for the normal income tax only, on their own account or in behalf of another, shall not be required to make return

Persons, firms, etc., having control of determinable income payable to others.

Normal tax to be deducted and return thereof made.

No return required unless income exceeds $3,000.

Interest in partnership profits to be included in return.

Partnerships must submit statements when required.

of the income derived from dividends on the capital stock or from the net earnings of corporations, joint-stock companies or associations, and insurance companies taxable upon their net income as hereinafter provided. Any person for whom return has been made and the tax paid, or to be paid as aforesaid, shall not be required to make a return unless such person has other net income, but only one deduction of $3,000 shall be made in the case of any such person. The collector or deputy collector shall require every list to be verified by the oath or affirmation of the party rendering it. If the collector or deputy collector have reason to believe that the amount of any income returned is understated, he shall give due notice to the person making the return to show cause why the amount of the return should not be increased, and upon proof of the amount understated may increase the same accordingly. If dissatisfied with the decision of the collector, such person may submit the case, with all the papers, to the Commissioner of Internal Revenue for his decision, and may furnish sworn testimony of witnesses to prove any relevant facts.

Dividends on stock, when to be excluded from return.

Returns to be verified by oath, and amended returns may be required by collector.

Appeals from decision of collector.

E. That all assessments shall be made by the Commissioner of Internal Revenue and all persons shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessments shall be paid on or before the thirtieth day of June, except in cases of refusal or neglect to make such return and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such person or persons immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, and for ten days after notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid, and interest at the rate of 1 per centum per month upon said tax from the

Assessments, notice, and payments of.

Limitation as to time when assessment may be paid without incurring penalty.

Penalty and interest in case of nonpayment within 10 days after June 30th.

time the same became due, except from the estates of insane, deceased, or insolvent persons.

Persons, firms, etc., withholding normal tax on behalf of others.

All persons, firms, copartnerships, companies, corporations, joint-stock companies or associations, and insurance companies, in whatever capacity acting, including lessees or mortgagors of real or personal property, trustees acting in any trust capacity, executors, administrators, agents, receivers, conservators, employers, and all officers and employees of the United States having the control, receipt, custody, disposal, or payment of interest, rent, salaries, wages, premiums, annuities, compensation, remuneration, emoluments, or other fixed or determinable annual gains, profits, and income of another person, exceeding $3,000 for any taxable year, other than dividends on capital stock, or from the net earnings of corporations and joint-stock companies or associations subject to like tax, who are required to make and render a return in behalf of another, as provided herein, to the collector of his, her, or its district, are hereby authorized and required to deduct and withhold from such annual gains, profits, and income such sum as will be sufficient to pay the normal tax imposed thereon by this section, and shall pay to the officer of the United States Government authorized to receive the same; and they are each hereby made personally liable for such tax. In all cases where the income tax of a person is withheld and deducted and paid or to be paid at the source, as aforesaid, such person shall not receive the benefit of the deduction and exemption allowed in paragraph C of this section except by an application for refund of the tax unless he shall, not less than thirty days prior to the day on which the return of his income is due, file with the person who is required to withhold and pay tax for him, a signed notice in writing claiming the benefit of such exemption and thereupon no tax shall be withheld upon the amount of such exemption: *Provided*, That if any person for the purpose of obtaining any allowance or reduction by virtue of a claim for such exemption, either for himself or for any other person, knowingly makes any false statement or false or fraudulent representation, he shall be liable to a penalty of $300; nor shall any person

Return to be made to collector of district.

Tax to be paid to officer authorized to receive same.

Notice must be filed in advance for claims for exemption under paragraph C.

Penalty for filing false claim.

under the foregoing conditions be allowed the benefit of any deduction provided for in subsection B of this section unless he shall, not less than thirty days prior to the day on which the return of his income is due, either file with the person who is required to withhold and pay tax for him a true and correct return of his annual gains, profits, and income from all other sources, and also the deductions asked for, and the showing thus made shall then become a part of the return to be made in his behalf by the person required to withhold and pay the tax, or likewise make application for deductions to the collector of the district in which return is made or to be made for him: *Provided further*, That if such person is a minor or an insane person, or is absent from the United States, or is unable owing to serious illness to make the return and application above provided for, the return and application may be made for him or her by the person required to withhold and pay the tax, he making oath under the penalties of this Act that he has sufficient knowledge of the affairs and property of his beneficiary to enable him to make a full and complete return for him or her, and that the return and application made by him are full and complete: *Provided further*, That the amount of the normal tax hereinbefore imposed shall be deducted and withheld from fixed and determinable annual gains, profits, and income derived from interest upon bonds and mortgages, or deeds of trust or other similar obligations of corporations, joint-stock companies or associations, and insurance companies, whether payable annually or at shorter or longer periods, although such interest does not amount to $3,000, subject to the provisions of this section requiring the tax to be withheld at the source and deducted from annual income and paid to the Government; and likewise the amount of such tax shall be deducted and withheld from coupons, checks, or bills of exchange for or in payment of interest upon bonds of foreign countries and upon foreign mortgages or like obligations (not payable in the United States), and also from coupons, checks, or bills of exchange for or in payment of any dividends upon the stock or interest upon the obligations of foreign corporations, associations,

Notice must be filed in advance for claim for deduction under paragraph B.

Returns, for minors, insane persons, etc., by whom made.

Normal tax to be deducted and withheld at source of income from bonds, etc., of corporations.

Dividends on stocks, or interest on foreign bonds, mortgages, etc.

and insurance companies engaged in business in foreign countries; and the tax in each case shall be withheld and deducted for and in behalf of any person subject to the tax hereinbefore imposed, although such interest, dividends, or other compensation does not exceed $3,000, by any banker or person who shall sell or otherwise realize coupons, checks, or bills of exchange drawn or made in payment of any such interest or dividends (not payable in the United States), and any person who shall obtain payment (not in the United States), in behalf of another of such dividends and interest by means of coupons, checks, or bills of exchange, and also any dealer in such coupons who shall purchase the same for any such dividends or interest (not payable in the United States), otherwise than from a banker or another dealer in such coupons; but in each case the benefit of the exemption and the deduction allowable under this section may be had by complying with the foregoing provisions of this paragraph.

License to be obtained by persons, etc., engaged in business of collecting foreign payments of interest, etc.

All persons, firms, or corporations undertaking as a matter of business or for profit the collection of foreign payments of such interest or dividends by means of coupons, checks, or bills of exchange shall obtain a license from the Commissioner of Internal Revenue, and shall be subject to such regulations enabling the Government to ascertain and verify the due withholding and payment of the income tax required to be withheld and paid as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe; and any person who shall knowingly undertake to collect such payments as aforesaid without having obtained a license therefor, or without complying with such regulations, shall be deemed guilty of a misdemeanor and for each offense be fined in a sum not exceeding $5,000, or imprisoned for a term not exceeding one year, or both, in the discretion of the court.

Penalty for failure to obtain license.

Liability for tax not affected by any contract entered into after passage of act.

Nothing in this section shall be construed to release a taxable person from liability for income tax, nor shall any contract entered into after this Act takes effect be valid in regard to any Federal income tax imposed upon a person liable to such payment.

The tax herein imposed upon annual gains, profits, and income not falling under the foregoing and not returned and paid by virtue of the foregoing shall be assessed by personal return under rules and regulations to be prescribed by the Commissioner of Internal Revenue and approved by the Secretary of the Treasury.

Deductions at source apply to normal tax only.

The provisions of this section relating to the deduction and payment of the tax at the source of income shall only apply to the normal tax hereinbefore imposed upon individuals.

Penalty for refusal or neglect to make required return or for making false return.

F. That if any person, corporation, joint-stock company, association, or insurance company liable to make the return or pay the tax aforesaid shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, such person shall be liable to a penalty of not less than $20 nor more than $1,000. Any person or any officer of any corporation required by law to make, render, sign, or verify any return who makes any false or fraudulent return or statement with intent to defeat or evade the assessment required by this section to be made shall be guilty of a misdemeanor, and shall be fined not exceeding $2,000 or be imprisoned not exceeding one year, or both, at the discretion of the court, with the costs of prosecution.

Penalty for making false or fraudulent return.

Normal tax to be assessed and paid on annual net income of corporations, joint-stock companies and associations.

G. (a) That the normal tax hereinbefore imposed upon individuals likewise shall be levied, assessed, and paid annually upon the entire net income arising or accruing from all sources during the preceding calendar year to every corporation, joint-stock company or association, and every insurance company, organized in the United States, no matter how created or organized, not including partnerships; but if organized, authorized, or existing under the laws of any foreign country, then upon the amount of net income accruing from business transacted and capital invested within the United States during such year: *Provided, however*, That nothing in this section shall apply to labor, agricultural, or horticultural organizations, or to mutual savings banks not having a capital stock represented by shares, or to fraternal beneficiary societies, orders, or associations oper-

Tax not to apply to certain organizations specified.

ating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system, and providing for the payment of life, sick, accident, and other benefits to the members of such societies, orders, or associations and dependents of such members, nor to domestic building and loan associations, nor to cemetery companies, organized and operated exclusively for the mutual benefit of their members, nor to any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual, nor to business leagues, nor to chambers of commerce or boards of trade, not organized for profit or no part of the net income of which inures to the benefit of the private stockholder or individual; nor to any civic league or organization not organized for profit, but operated exclusively for the promotion of social welfare: *Provided further*, That there shall not be taxed under this section any income derived from any public utility or from the exercise of any essential governmental function accruing to any State, Territory, or the District of Columbia, or any political subdivision of a State, Territory, or the District of Columbia, nor any income accruing to the government of the Philippine Islands or Porto Rico, or of any political subdivision of the Philippine Islands or Porto Rico: *Provided*, That whenever any State, Territory, or the District of Columbia, or any political subdivision of a State or Territory, has, prior to the passage of this Act, entered in good faith into a contract with any person or corporation, the object and purpose of which is to acquire, construct, operate or maintain a public utility, no tax shall be levied under the provisions of this Act upon the income derived from the operation of such public utility, so far as the payment thereof will impose a loss or burden upon such State, Territory, or the District of Columbia, or a political subdivision of a State or Territory; but this provision is not intended to confer upon such person or cor-

Income derived from public utilities or governmental functions accruing to States, Territories, etc.

poration any financial gain or exemption or to relieve such person or corporation from the payment of a tax as provided for in this section upon the part or portion of the said income to which such person or corporation shall be entitled under such contract.

Exemptions not to apply to gains or profits derived from contracts by persons or corporations.

(b) Such net income shall be ascertained by deducting from the gross amount of the income of such corporation, joint-stock company or association, or insurance company, received within the year from all sources, (first) all the ordinary and necessary expenses paid within the year in the maintenance and operation of its business and properties, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any; and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such

Net income of corporations, joint-stock companies, etc., how ascertained.

Losses and depreciations.

Mutual fire insurance companies.

Mutual marine insurance companies.

amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding one-half of the sum of its interest bearing indebtedness, and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of its indebtedness not exceeding the amount of capital employed in the business at the close of the year: *Provided*, That in case of indebtedness wholly secured by collateral the subject of sale in ordinary business of such corporation, joint-stock company, or association, the total interest secured and paid by such company, corporation, or association within the year on any such indebtedness may be deducted as a part of its expense of doing business: *Provided further*, That in the case of bonds or other indebtedness, which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; and in the case of a bank, banking association, loan, or trust company, interest paid within the year on deposits or on moneys received for investment and secured by interest-bearing certificates of indebtedness issued by such bank, banking association, loan or trust company; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof, or imposed by the Government of any foreign country: *Provided*, That in the case of a corporation, joint-stock company or association, or insurance company, organized, authorized, or existing under the laws of any foreign country, such net income shall be ascertained by deducting from the gross amount of its income accrued within the year from business transacted and capital invested within the

Life insurance companies.

To what extent interest accruing and paid during the year on indebtedness may be deducted from income.

Bonds issued with guaranty that interest shall be free from taxation.

Interest on deposits may be deducted from gross income.

Taxes paid.

Foreign corporations, etc., income from business in United States.

United States, (first) all the ordinary and necessary expenses actually paid within the year out of earnings in the maintenance and operation of its business and property within the United States, including rentals or other payments required to be made as a condition to the continued use or possession of property; (second) all losses actually sustained within the year in business conducted by it within the United States and not compensated by insurance or otherwise, including a reasonable allowance for depreciation by use, wear and tear of property, if any, and in the case of mines a reasonable allowance for depletion of ores and all other natural deposits, not to exceed 5 per centum of the gross value at the mine of the output for the year for which the computation is made; and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such

Ordinary expenses, rentals, etc.

Losses and depreciation.

Reserve funds of insurance companies.

Mutual fire insurance.

Mutual marine insurance.

Interest accruing and paid during the year on indebtedness.

year; (third) the amount of interest accrued and paid within the year on its indebtedness to an amount of such indebtedness not exceeding the proportion of one-half of the sum of its interest bearing indebtedness and its paid-up capital stock outstanding at the close of the year, or if no capital stock, the capital employed in the business at the close of the year which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States: *Provided*, That in the case of bonds or other indebtedness which have been issued with a guaranty that the interest payable thereon shall be free from taxation, no deduction for the payment of the tax herein imposed shall be allowed; (fourth) all sums paid by it within the year for taxes imposed under the authority of the United States or of any State or Territory thereof or the District of Columbia. In the case of assessment insurance companies, whether domestic or foreign, the actual deposit of sums with State or Territorial officers, pursuant to law, as additions to guarantee or reserve funds shall be treated as being payments required by law to reserve funds.

Bonds whose makers have agreed to pay interest without tax deduction.

Taxes.

Insurance reserve funds.

Tax to be computed on net income accruing each calendar year.

(c) The tax herein imposed shall be computed upon its entire net income accrued within each preceding calendar year ending December thirty-first: *Provided, however*, That for the year ending December thirty-first, nineteen hundred and thirteen, said tax shall be imposed upon its entire net income accrued within that portion of said year from March first to December thirty-first, both dates inclusive, to be ascertained by taking five-sixths of its entire net income for said calendar year: *Provided further*, That any corporation, joint-stock company or association, or insurance company subject to this tax may designate the last day of any month in the year as the day of the closing of its fiscal year and shall be entitled to have the tax payable by it computed upon the basis of the net income ascertained as herein provided for the year ending on the day so designated in the year preceding the date of assessment instead of upon the basis of the net income for

But fiscal year other than calendar may be designated by corporations.

the calendar year preceding the date of assessment; and it shall give notice of the day it has thus designated as the closing of its fiscal year to the collector of the district in which its principal business office is located at any time not less than thirty days prior to the date upon which its annual return shall be filed. All corporations, joint-stock companies or associations, and insurance companies subject to the tax herein imposed, computing taxes upon the income of the calendar year, shall, on or before the first day of March, nineteen hundred and fourteen, and the first day of March in each year thereafter, and all corporations, joint-stock companies or associations, and insurance companies, computing taxes upon the income of a fiscal year which it may designate in the manner hereinbefore provided, shall render a like return within sixty days after the close of its said fiscal year, and within sixty days after the close of its fiscal year in each year thereafter, or in the case of a corporation, joint-stock company or association, or insurance company, organized or existing under the laws of a foreign country, in the place where its principal business is located within the United States, in such form as the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, shall prescribe, shall render a true and accurate return under oath or affirmation of its president, vice president, or other principal officer, and its treasurer or assistant treasurer, to the collector of internal revenue for the district in which it has its principal place of business, setting forth (*first*) the total amount of its paid-up capital stock outstanding, or if no capital stock, its capital employed in business, at the close of the year; (*second*) the total amount of its bonded and other indebtedness at the close of the year; (*third*) the gross amount of its income, received during such year from all sources, and if organized under the laws of a foreign country the gross amount of its income received within the year from business transacted and capital invested within the United States; (*fourth*) the total amount of all its ordinary and necessary expenses paid out of earnings in the maintenance and operation of the business and properties of such corporation, joint-stock com-

Returns, when to be rendered.

Returns, under oath or affirmation to be filed with collector of district.

Information to be included in return of corporation.

Paid-up capital.

Bonded indebtedness.

Gross income.

Ordinary expenses of operation and maintenance.

Rental, etc.

pany or association, or insurance company within the year, stating separately all rentals or other payments required to be made as a condition to the continued use or possession of property, and if organized under the laws of a foreign country the amount so paid in the maintenance and operation of its business within the United States; (*fifth*) the total amount of all losses actually sustained during the year and not compensated by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them, and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; and in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign country, all losses actually sustained by it during the year in business conducted by it within the United States, not compensated

Losses and depreciation.

Additional reserve funds.

Certain premium deposits not to be returned as taxable income.

Premiums, reinsurance, etc.

Foreign corporations doing business in the United States.

by insurance or otherwise, stating separately any amounts allowed for depreciation of property, and in case of insurance companies the net addition, if any, required by law to be made within the year to reserve funds and the sums other than dividends paid within the year on policy and annuity contracts: *Provided further*, That mutual fire insurance companies requiring their members to make premium deposits to provide for losses and expenses shall not return as income any portion of the premium deposits returned to their policyholders, but shall return as taxable income all income received by them from all other sources plus such portions of the premium deposits as are retained by the companies for purposes other than the payment of losses and expenses and reinsurance reserves: *Provided further*, That mutual marine insurance companies shall include in their return of gross income gross premiums collected and received by them less amounts paid for reinsurance, but shall be entitled to include in deductions from gross income amounts repaid to policyholders on account of premiums previously paid by them and interest paid upon such amounts between the ascertainment thereof and the payment thereof and life insurance companies shall not include as income in any year such portion of any actual premium received from any individual policyholder as shall have been paid back or credited to such individual policyholder, or treated as an abatement of premium of such individual policyholder, within such year; (*sixth*) the amount of interest accrued and paid within the year on its bonded or other indebtedness not exceeding one-half of the sum of its interest bearing indebtedness and its paid-up capital stock, outstanding at the close of the year, or if no capital stock, the amount of interest paid within the year on an amount of indebtedness not exceeding the amount of capital employed in the business at the close of the year, and in the case of a bank, banking association, or trust company, stating separately all interest paid by it within the year on deposits; or in case of a corporation, joint-stock company or association, or insurance company, organized under the laws of a foreign

Reserve fund.

Mutual fire insurance companies.

Mutual marine insurance companies.

Life insurance companies.

What interest on bonded indebtedness may be deducted.

Interest paid on deposits deductible from incomes.

country, interest so paid on its bonded or other indebtedness to an amount of such bonded or other indebtedness not exceeding the proportion of its paid-up capital stock outstanding at the close of the year, or if no capital stock, the amount of capital employed in the business at the close of the year, which the gross amount of its income for the year from business transacted and capital invested within the United States bears to the gross amount of its income derived from all sources within and without the United States; (*seventh*) the amount paid by it within the year for taxes imposed under the authority of the United States and separately the amount so paid by it for taxes imposed by the Government of any foreign country; (*eighth*) the net income of such corporation, joint-stock company or association, or insurance company, after making the deductions in this subsection authorized. All such returns shall as received be transmitted forthwith by the collector to the Commissioner of Internal Revenue.

Interest on indebtedness of foreign corporations.

Taxes paid.

Net income to be shown on return.

All assessments shall be made and the several corporations, joint-stock companies or associations, and insurance companies shall be notified of the amount for which they are respectively liable on or before the first day of June of each successive year, and said assessment shall be paid on or before the thirtieth day of June: *Provided*, That every corporation, joint-stock company or association, and insurance company, computing taxes upon the income of the fiscal year which it may designate in the manner hereinbefore provided, shall pay the taxes due under its assessment within one hundred and twenty days after the date upon which it is required to file its list or return of income for assessment; except in cases of refusal or neglect to make such return, and in cases of false or fraudulent returns, in which cases the Commissioner of Internal Revenue shall, upon the discovery thereof, at any time within three years after said return is due, make a return upon information obtained as provided for in this section or by existing law, and the assessment made by the Commissioner of Internal Revenue thereon shall be paid by such corporation, joint-stock

Assessments to be made, and notice to be given.

Assessed taxes, when to be paid by corporation, etc.

When false return has been rendered and facts are detected within 3 years, commissioner may make new assessment.

company or association, or insurance company immediately upon notification of the amount of such assessment; and to any sum or sums due and unpaid after the thirtieth day of June in any year, or after one hundred and twenty days from the date on which the return of income is required to be made by the taxpayer, and after ten days notice and demand thereof by the collector, there shall be added the sum of 5 per centum on the amount of tax unpaid and interest at the rate of 1 per centum per month upon said tax from the time the same becomes due.

Penalty and interest incurred by failure to pay tax within prescribed time.

(d) When the assesment shall be made, as provided in this section, the returns, together with any corrections thereof which may have been made by the commissioner, shall be filed in the office of the Commissioner of Internal Revenue and shall constitute public records and be open to inspection as such: *Provided*, That any and all such returns shall be open to inspection only upon the order of the President, under rules and regulations to be prescribed by the Secretary of the Treasury and approved by the President: *Provided further*, That the proper officers of any State imposing a general income tax may, upon the request of the governor thereof, have access to said returns or to an abstract thereof, showing the name and income of each such corporation, joint stock company, association or insurance company, at such times and in such manner as the Secretary of the Treasury may prescribe.

Returns rendered to be filed with Commissioner of Internal Revenue

Returns to be open to inspection under certain conditions.

If any of the corporations, joint-stock companies or associations, or insurance companies aforesaid, shall refuse or neglect to make a return at the time or times hereinbefore specified in each year, or shall render a false or fraudulent return, such corporation, joint-stock company or association, or insurance company shall be liable to a penalty of not exceeding $10,000.

Penalty to corporations, etc., for refusing or neglecting to file required return.

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Section 4 (paragraph S) of the act of October 3, 1913, further provides * * * That a special excise tax with respect to the carrying on or doing of business, equivalent to 1 per centum upon their entire net income, shall

Income subject to special excise tax under act of Aug. 5, 1909.

be levied, assessed, and collected upon corporations, joint stock companies or association, and insurance companies, of the character described in section thirty-eight of the act of August fifth, nineteen hundred and nine, for the period from January first to February twenty-eighth, nineteen hundred and thirteen, both dates inclusive, which said tax shall be computed upon one-sixth of the entire net income of said corporations, joint stock companies or associations, and insurance companies, for said year, said net income to be ascertained in accordance with the provisions of subsection G of section two of this act: *Provided further*, That the provisions of said section thirty-eight of the act of August fifth, nineteen hundred and nine, relative to the collection of the tax therein imposed shall remain in force for the collection of the excise tax herein provided, but for the year nineteen hundred and thirteen it shall not be necessary to make more than one return and assessment for all the taxes imposed herein upon said corporations, joint stock companies or associations, and insurance companies, either by way of income or excise, which return and assessment shall be made at the times and in the manner provided in this act. * * *

One return may be filed for both special excise and income tax for year 1913.

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